

New  
Philanthropy  
Capital

# Granting success

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## Lessons from funders and charities



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# Summary: Granting success

Imagine that you are a funder looking over hundreds of funding applications from charities—how do you decide which charities to fund? How much do you give to each of them? And over how many years? What if the charity does not quite fit your mission? Should you, the grant-maker, decide what the funding is used for, or should you let the charity decide?

Now imagine that you are running a charity and have just received a grant. You are delighted to have been successful, but it turns out to be only one year of funding for a staff post, with many conditions attached. Will you be able to recruit the best person for the job? What happens at the end of the year? What if you need to use the money for something else in an emergency?

**The way that charities are funded has a direct impact on the lives of those they support. To achieve the best for beneficiaries, charities need to be funded in ways that help them to create the most impact.**

This report looks at grant-making practices in the UK to provide guidance to funders on how to approach funding. It specifically focuses on the structure of grants and offers lessons and guidance from grant-makers, based on their experiences.

## Lessons from funders and charities

NPC has spoken with hundreds of charities since its inception in 2001, and has frequently heard that the structure of grants impacts their work. For this research, we conducted a literature review, consulted experts and interviewed 17 staff from a range of UK trusts and foundations. We wanted to understand what motivates their decisions on funding and how they address practical considerations. We also spoke to three experts about non-grant financing.

## More effective giving

NPC believes that funders can strengthen charities, increase their impact and change the lives of beneficiaries, by improving the way that they fund charities. In NPC's experience, funders that take time to understand the needs and approaches of the charities they fund can improve the way those charities work. This has a knock-on effect on the lives of beneficiaries—good grant-making improves more lives. Better impact can be achieved by:

- structuring grants so that they create the greatest impact, by making grants of the appropriate size, length and level of restriction;
- funding effective activities, by working out which charities and projects have the greatest impact;
- helping charities to improve their effectiveness, for example, by supporting charities to develop valuable infrastructure, or by funding research and evaluation; and
- adding value in other ways, for example, hosting networking events, or publishing and sharing the lessons they have learnt.

This report focuses on the first of these issues: structuring grants.

## Why does grant structure matter?

Well-structured funding achieves better results by giving charities the ability to recruit and retain the best staff, opportunities to plan and innovate, resources to track results, and the flexibility to respond to social, political or legal changes. Security of funding is essential for the long-term relationships that charities have with vulnerable people.

However, not all funding is structured to maximise impact. Poorly-designed funding harms charities by limiting their ability to develop their organisations and to plan, innovate, measure results, and respond to change. At worst, poor funding creates uncertainty, making recruitment and retention of staff difficult, and damaging staff morale. This in turn affects the quality of service offered to beneficiaries.

Funders should keep the interests of beneficiaries uppermost in their minds when structuring grants to charities. However, publicly available guidance on this topic for UK funders is limited. There are practical constraints and compromises that affect how donors can fund. This report looks at three aspects of how funding is structured: size and length of grant; restrictions on what a grant is used for; and non-grant financing, such as loans.

## Defining effectiveness

For NPC, effectiveness in the charity sector means maximising the improvement in people's lives, by helping people more profoundly, reaching more people, and creating lasting change for the better. To fund effectively, funders need to make good decisions about what issues to address, how to address them, and which organisations to work with. They need to understand what makes charities effective and support their endeavours to become effective.

To be effective, charities should focus on activities that make a real difference; use evidence of results to improve performance; optimise the use of resources; and be ambitious to solve problems rather than perpetuate their own existence. Good leadership is vital to being effective.

Together, funders and charities can increase charity effectiveness, thereby improving the lives of those they are trying to help.

# Three years' funding may well be too short to make an impact.

Funder

## Size and length

Funders may have to choose between giving a lot to one charity and giving smaller amounts to several charities; or between giving stable funding for many years and being responsive and experimental. It is now widely recognised that funders should commit to funding charities for at least three years, unless the grants are for one-off items such as capital appeals or specific tasks (eg, research). Funding of an inappropriate size or length affects charities in the following ways:

**Grant too small:** An under-funded post or project requires a charity to spend resources finding the short-fall, and this can delay the start of activities. Posts and projects whose overhead costs are not fully covered place a strain on charity finances. Insufficient funding can limit a charity's ability to recruit the best staff for the activity being funded.

Small grants can be useful if they are unrestricted, because they can cover costs that charities might otherwise struggle to pay. Small grants are also useful for small projects, low-cost items, and seed capital for start-up charities.

**Grant too big:** If a grant is too big, a charity may expand too rapidly beyond the capacity of staff and management. Or the charity may expand services that cannot be funded once the grant has ended, in which case the services contract again and there is no lasting value from the investment.

**Funding too short:** If an activity or project is funded for too short a period, it may have to stop before it is completed, before its impact is fully realised, or before alternative funding has been secured. Funding for short periods makes recruitment and retention of staff difficult. However, short-term funding is suitable for capital expenditure or short projects.

At the outset, funders should consider what will happen after their funding stops, and whether other funding is likely to be available. NPC is aware of

cases where no service at all would have been preferable to a service that starts and then suddenly stops due to funding problems, which can leave vulnerable clients feeling abandoned.

**Funding too long:** Long-term funding carries the risk that circumstances change during the period of the grant. The need or activity may evolve, or the charity's performance may decrease, meaning that funding could be better used for other purposes. If funding is long term, funders should review it periodically to check that the grant is still appropriate.

## Guidance for funders

Funders have finite resources to allocate, in terms of funds, time and staff. They may want to split funding between many charities, spread risk, fund in different geographies, or fund different sectors. But the costs of funding increase with the number of charities funded, because of the time required to manage and monitor more relationships (see table). Charities with a larger number of funders also incur higher costs.

### Size and length of funding: trade-offs between diversity and risk-spreading against efficiency and effectiveness

Why diversify funding?	Potential trade-offs
Spread risk	Charity effectiveness (grants too small)
Cover different geographies	
Cover different sectors	Charity efficiency (transaction costs)
Fund different activities	Funder efficiency (transaction costs)
Broaden sector knowledge	Funder capacity (staff)

NPC's research uncovered a number of circumstances in which trade-offs are difficult to avoid.

## Resource constraints

Most donors have fixed amounts to give. If funders' means are limited, they could choose to fund a small group of charities well. Or they could fund activities that require small amounts of funding but still achieve impact. Small sums, carefully targeted, have achieved tangible change. For example, a small grant of £10,000 paid for the development of a tool for the palliative care sector, helping organisations to measure the quality of their services.

The government now promotes this tool in its End of Life Strategy.

## Multiple missions and interests

Funders may want to fund work in different locations, fund different issues, or fund a range of activities addressing the same issue. A balance has to be struck between funding in a number of areas and giving enough to create an impact in each.

Most social and environmental problems can be tackled in more than one way—for example: by scientific or clinical research; by providing direct services to people; or by lobbying for change. A combination of approaches can be effective. Funders may feel that they want to attack an issue from many sides, especially if they coordinate the approaches. This is justified as long as charities' effectiveness is not compromised by grants that are too small.

## Diversity and knowledge

Some funders learn a lot about a sector by funding a range of different charities, which enables them to compare different approaches. Others learn more by funding across a range of sectors. Such knowledge could usefully be shared with charities and other funders.

For instance, an experienced funder might identify a need for an umbrella body in a sector because the funder has seen how an effective umbrella body in another sector works. The same funder may even help to create one.

Sharing this knowledge and using it constructively would help to mitigate some of the disadvantages and costs of having a broad portfolio of small-sized grants.

## Using smaller grants to attract other funders

Funders may want to part-fund an activity or project to encourage other, more suitable funders to pay for work on a larger scale, for example, when an activity is suitable for government support.

## Other considerations voiced by funders

A few funders had concerns that others we interviewed disagreed with. Some funders were wary of providing large grants because they felt they could not assess or monitor them adequately, due to constraints on staff time. This problem could be solved by persuading trustees to invest more in their staff or by finding ways to use existing staff time better. Funders'

trustees sometimes prefer giving a larger number of smaller grants in order to be 'fair' to all applicants. A key task of funders is to discriminate between applicants, and funders should be wary of compromising the quality of their funding under the weight of applications they receive.

Larger, longer grants can lead to what some funders referred to as 'dependency', but most felt that this is a natural consequence of funding that is to be managed, rather than avoided. Some funders felt that their policies on size and length of grants were 'habits' developed over time, and perhaps should be reviewed regularly.

Many voluntary organisations do not have the capacity to build up reserves that allow them to develop against problem scenarios.

Funder

## Restrictions

Donors sometimes restrict how money is used. They might specify:

**Inputs**—usually specific costs and budget line items. For instance, a funder may specify that the funding can be used for salaries but not rent or electricity. Or a funder may fund a particular post, such as a nurse, or an item, such as a minibus.

**Outputs**—usually activities or items. The funder might specify a number of hours of reading help, or a number of nights of nursing, or the production of a report.

**Outcomes**—that is, improvements for beneficiaries. For example, the funder might seek increased literacy levels or better well-being for children.

**Groups, geographies or themes**—such as refugees and asylum seekers, Southwark borough, or education.

Donors use restrictions because they feel that monitoring grants is easier when restricted; because they want to avoid dependency and mitigate risk; or because they do not know a charity well enough. But restrictions can limit the effectiveness of the grant, as charities:

- are hindered from paying for essential infrastructure and organisational development;
- find it difficult to innovate and experiment;
- are prevented from responding to unexpected events; and
- spend resources on managing restrictions rather than pursuing results.

The tighter and more inflexible the restrictions, the more onerous the management of the grant for the charity and funder.

## Guidance for donors

NPC favours unrestricted funding. A well-run charity will be the best judge of how to spend money to help beneficiaries most effectively. If a funder has fully assessed a charity, and believes the charity worthy of funding, then unrestricted funding will be the most beneficial. There are exceptions, which are described below. But where restrictions are made, funders should choose the lightest restriction possible and should be responsive in the face of changes to the charity. The more flexible the restrictions, the better (see figure).

## Aligning objectives between funder and charity

Sometimes the missions of funders and charities are not fully aligned. For example, a donor that usually funds refugee organisations might decide to fund an environment charity because of its refugee volunteering programme. In some cases, donors may risk working outside their charitable objectives if they give unrestricted funding to a charity that works

with several beneficiary groups. In these cases, the missions are very different, so restrictions may be appropriate.

## Different restrictions carry different burdens—an example from a literacy charity

	restrictions	examples	
More specific restriction ↑	inputs	a new teacher	↓ More flexible for charity
	outputs	100 hours of reading help	
	outcomes	improved literacy	
	beneficiaries and themes	education	

Funders should avoid giving where the misalignment between the charity and funder mission is too great. Charities are sometimes tempted to pursue funding that lies outside their core competency. The funded activity should not result in a charity drifting from its mission or expertise. And funders should choose the charity that is best able to do the job.

## Reputation risk

Funders may occasionally have to protect their reputation by retaining control over what their funding is spent on. Such funders include those that are accountable to parliament, fundraise from the public, or are corporate foundations.

## Influencing the charity

Restrictions can be used to influence a charity. If a funder has particular knowledge of an issue, of an intervention, or of a charity itself, the funder may be well-placed to identify unrecognised opportunities. For example, a donor might decide to improve a charity's infrastructure by funding it to recruit a finance director. Funders need to justify clearly why they are imposing such restrictions. Agreement from the charity is essential, or the charity may not meaningfully change its behaviour.

## Presentation of financial circumstances

In some cases, charities raising funds find it helpful to show that some of their funding is restricted to specific projects. For example, a charity that is saving for a new building may have large amounts of reserves set aside for the purpose. If funding is restricted, it can be easier to ask other funders for money for operating costs and other projects, without putting them off by having large unrestricted reserves.

### Giving unrestricted funding

Funders unaccustomed to giving unrestricted funding will have to adjust to judging the outcomes of the whole organisation they are funding, rather than tying funding and monitoring to a specific project. Funders will need to engage more with charities and understand their work better. This may require investment in staff, time and resources, but in return, the impact of the funding should increase.

### Good practice when restricting

Our research suggests that funders should choose the lightest restriction possible that achieves their objective. They should also be flexible and approachable. This means making grantees aware of the circumstances in which restrictions can be altered and how they should approach the funder on this.

## Non-grant financing

In some areas, a funder might have a greater impact by offering non-grant financing in the form of a guarantee or loan. Funders are increasingly offering this option to charities.

Many types of charitable activity are not suitable for loans. But where loans can be used, they have benefits—recycling of money, building the capacity of organisations, and bringing new sources of money to the sector.

If grant-makers are going to make loans, it can make more sense to use specialist intermediaries such as Venturesome and Charity Bank, rather than developing loan expertise in-house. These intermediaries can then undertake financial assessments and manage relationships, reducing the risks and costs to the grant-maker.

## Conclusions

Making decisions about size, length and restrictions on grants is about finding ways to make funding work best for beneficiaries, while navigating around the constraints and risks that arise in funding relationships. By reflecting on the implications of grant structure, grant-makers could improve their funding so that it has the greatest impact. This can change the way that charities work and, ultimately, deliver better outcomes for beneficiaries.

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# Introduction

**Grant-makers\* in the UK give away around £3bn a year. Making sure this is given to good effect is by no means an easy task. The best way to design grants is determined by what they are intended to achieve, the types of issue and organisation they support, and the total available resources. Getting this right can make a great difference. But sometimes the way grants are structured hinders charities.**

Through experience—both successes and failures—funders learn lessons about the best ways to structure grants. Based on these lessons, they refine their approaches. But for funders new to giving, there is little guidance or research available to help them get started, and avoid the mistakes that more established funders know not to make. The established funders NPC interviewed for this report were enthusiastic about the importance of sharing lessons and encouraging best practice in funding.

This report is aimed at providing new funders with guidance on how to develop their own approach to making grants. NPC hopes it is also an opportunity for more experienced funders to reflect on the practices of others.

## What does this research cover?

This report is primarily addressed at professional independent funders, but the guidance within it will also be relevant to many private donors and statutory funders, although they have different accountability requirements.

This research addresses three questions that funders face when supporting charities:

- How should I decide the **size and length** of grants?
- How should I decide what **restrictions** to place on grants?
- Should I offer **non-grant financing**, and if so, how?

These questions were chosen because they are core to how funders support charities. Moreover, NPC has observed that practice varies between grant-makers, making it particularly valuable to share the lessons learned.

This report addresses each question in terms of what will maximise the impact on beneficiaries—those people that funders and charities aim to help. As there is no single answer to these three questions, NPC's approach is to understand the various considerations that funders take into account and to provide guidance on how these considerations can be weighed up against one another to achieve the best answers.

## How is this report structured?

The report is divided into three chapters, which address each of the questions in turn:

- Chapter 1: Size and length of grants
- Chapter 2: Restrictions
- Chapter 3: Non-grant financing

First we discuss the factors that influence funders' decisions. We assess these factors and examine the impact of decisions on charities and beneficiaries, and then identify lessons that can be learnt.

The Conclusions draw together some of the themes that impact on all these funding decisions.

The Appendices contain the questions we asked donors and charities; an example of an outcomes monitoring report for a whole organisation; and further resources for grant-makers.

## What is beyond the scope of this report?

Structuring grants well is only one aspect of good funding practice, and this report is not intended as a complete guide. Other aspects, such as selecting causes or charities to support, or monitoring and measuring the results of grants, are beyond the scope of this report.

\* The terms *grant-makers*, *donors* and *funders* are used interchangeably throughout this report.

## How did we do the research?

This report is based on analysis of interviews with funders, charities and a selection of experts as well as literature, research and data.

In scoping this research, NPC spoke to a selection of experts to obtain other perspectives on what research was needed on funding, and barriers to improved funding practice.

We conducted a literature review, and looked at what evidence is available on the impact of funding practices on charities and their effectiveness, as well as what gaps in research exist.

Through the course of our research, we interviewed 17 staff from UK trusts and foundations to understand what motivates their decisions on funding, and how they address various practical considerations. We added to this knowledge derived through practice by reviewing findings about funding in literature. The funders interviewed were diverse. They varied in the total amounts they give; the amount of resource invested in making grants; the issues they address; and their level of engagement with the issues and organisations they support.

NPC has spoken with hundreds of charities since its inception, and has frequently heard that the structure of grants impacts their work. For this report, we reflected on this prior experience as well as interviewing a handful of charities that had previously had issues with some grants, to hear more details of their experiences.

We asked all 17 trusts and foundations about non-grant financing, and also spoke with three experienced providers of non-grant financing to obtain their views on how grant-makers should address this.

While this research is not exhaustive, it does reflect a broad spectrum of views across the sector and highlights different practices. It also highlights similarities: very different donors frequently have similar experiences, and NPC believes that our guidance for donors is widely applicable.

## About New Philanthropy Capital

New Philanthropy Capital (NPC) is a charity that maximises the impact of donors and charities—it does this through independent research, tools for charities and advice for donors. Its research guides donors on how best to support causes such as cancer, education and mental health. As well as highlighting the areas of greatest need, NPC identifies charities that could use donations to best effect. Using this research, it advises clients and their trusted advisors, and helps them think through issues such as:

- Where is my support most needed and what results could it achieve?
- Which organisation could make the best use of my money?
- What is the best way to support these organisations?

NPC is very thankful to the Big Lottery Fund for part-funding this research. The views expressed in this report are those of NPC and not the Big Lottery Fund.

# Size and length of grants

When deciding how much to give, and for how long, funders balance what will best achieve their outcomes with other considerations.

Structuring funding appropriately enables funders to achieve the highest impact and gives charities financial security, making it easier for them to plan, develop new services and provide a better service to beneficiaries. But if the amount of funding or the time period over which it is given is not appropriate, it becomes harder for charities to achieve the outcomes and the effectiveness of the funding is reduced.

This chapter guides funders through the considerations that inform decisions about size and length of grants.

## An introduction to size and length

When thinking about the amount, or size, of a grant, one must consider both the absolute size and the size relative to the work being funded or relative to the funded organisation overall. For example, for a small charity a grant of £10,000 may be a lot of money, but for a multi-million pound organisation like Cancer Research UK, it is comparatively little.

The period over which funding is given, or length of funding, can also be considered both in absolute and relative terms. It became clear from NPC's interviews that there is no consensus over what is considered a long grant. For simplicity in this report, grants for three years or more are described as long, and less than that as short.

Many of the factors that affect the size of grant also influence its length; hence the two issues are grouped together here. In this chapter we generally talk about funding for projects, because that is often the reality of charity funding. However, such restricted funding is not always appropriate for charities (see Chapter 2 for more information).

While individual grant-makers publish data on the size of their grants, there is little public data on the size and length of grants in aggregate. One small survey of charities found that over three quarters of funding from trusts and foundations is given as a 'one-off', rather than over a period of time.<sup>1</sup>

## An ideal world

Many grant-makers told NPC that effectiveness was their prime consideration, because they were keen to ensure that their funding makes the biggest impact possible and achieves the best results for beneficiaries.

Grant-makers told us that the major limitation on this is the resources of the trust. But many grant-makers find ways to fund according to best practice within their resource constraints, for instance, by consolidating grants (see Box 1). One small trust decided it was best to concentrate on one particular cause, where it had built up expertise and piloted new methods of monitoring. Despite its limited funds, it is therefore an influential actor in its sector.

When future income is uncertain, it can lead grant-makers to limit their giving to shorter grants. Many non-endowed trusts get around this by putting aside money in the first year to cover the future commitments of each grant.

## Flexible funding practices are needed to respond to the need

There are many different varieties of charitable work, requiring different types of charitable funding. As a funder, being aware of the types of funding required to support activities within an area means that funding streams can be designed to fit them. For instance, funding research often requires large grants, whereas a small community organisation may need a modest grant. Small grants with lower

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### Box 1: The Nuffield Foundation

The Nuffield Foundation provides funding for research in education, science, law and social policy. One of its funding streams, the Oliver Bird Programme, produces £500,000 every year. Endowed by Captain Oliver Bird in 1948, this subsidiary endowment is dedicated by its trust deed to research into the causes of rheumatic diseases. The Nuffield Foundation reviewed its support under the programme and concluded that the grants it was making were too small to contribute significantly to research in a field where there were funders operating on a much larger scale.

It decided to consolidate all the money into one programme for ten years. It has made grants of £1m each to five universities to fund doctoral students. By supporting these seventy or so young scientists within a single coherent programme, its ambition is to make a significant long-term contribution to the field.

**Box 2: Small grants programmes**

A small grants programme can have lower application, monitoring and reporting burdens than a standard programme, and therefore enable many small grants to be given away without significantly increasing the administration costs. Funders who have a set objective, such as improving educational outcomes, can have both a small grants programme and a large grants programme, which each address educational outcomes. This has the benefit of helping funders keep their finger on the pulse of what is going on—a wide breadth of applications is a good source of information about the sector—but also means that the administration burden on both funders and applicants is proportional to the size of funding.

application and reporting requirements are often useful for a charity to pilot new work and can be the seed that leads to greater things (see Box 2). This can be especially useful for small community and voluntary initiatives.

The length of funding must also be appropriate to ensure that the aim of the funding is achieved. Some projects are naturally time-limited; for example, one-off events or reports. Some projects take longer to get going; for example, work with disengaged groups. For these types of work, funding should be longer than usual.

**Why is size and length of funding important?**

If the funding is not appropriate to the work and the organisation in terms of size and duration, then its impact is reduced and may even be detrimental. Giving less money than is needed can result in the activity proceeding at a smaller scale—it can mean delays while other funding is sought, or a lack of funding to cover overheads. Giving more than is appropriate can result in a charity growing too quickly. Funding that is too short can result in poor staff morale, as staff are required to work on short contracts. Therefore, funders need to consider the size and length of grants if they are to make their grants as effective as possible.

**What factors do grant-makers take into account?**

From our literature review and interviews, NPC found that grant-makers commonly took the following considerations into account when considering the size and length of grants:

- grant-makers' capacity;
- diversity (spreading grants around);
- dependency (charities becoming too reliant on funders);
- attributing impact; and
- fairness, tradition, and trust in the charity.

These factors are all considered in different ways by different grant-makers. They will each be discussed in depth in this chapter, alongside lessons from how grant-makers think about them.

**Grant-makers' capacity**

Grant-makers told NPC that the amount of available staff time affects decisions about size and length of grants. Lack of time to spend on assessing applications means that some funders are wary of giving larger grants.

During interviews, NPC was told that there are a number of ways to deal with this. One approach is to free up staff time by limiting the number of applications a trust receives by, for example, having clearer, more specific guidelines. This helps charities decide if there is likely to be a match before they start applying. Another method is to have a two-stage application process, allowing applicants who are not likely to succeed to be weeded out more quickly. Clear funding criteria and a two-stage application process lessen the burden on trusts and on charities.

Trustees can also increase the amount that a trust spends on administration costs and employ more staff. Employing more staff may mean that grant-makers can give smaller grants more efficiently and/or give larger grants, having done a proper assessment. This obviously represents a trade-off: saving money on staff means more money to spend on grants, but having more staff may mean funding charities more effectively.

However, if funders were to give longer and larger grants, this would decrease the amount they spend on administration costs, and free up money to spend on grants. The data we would need to calculate this figure is not robust enough—but the cost savings could potentially reach hundreds of millions of pounds each year for charities and funders. This is made up by funders spending less time assessing grants, and charities spending less time on applying for grants, although there would have to be an increase in time spent on monitoring grants.

One trust NPC spoke to moved to making larger grants over a longer period because it wanted to concentrate on making fewer, better grants and researching the effectiveness of its grant-making, rather than giving grants mechanically without much thought. This benefits the sector as a whole through the research, and allows the grant-maker to make more effective grants.

If the funding is not appropriate to the work and the organisation in terms of size and duration, then its impact is reduced and may even be detrimental.

Sometimes trustee capacity is the bottle neck. For example, some trust staff work out that the trust has x amount of money to give away each year, has y trustee meetings to do that in, and each trustee meeting could cope with z applications. So the traditions of the internal workings of the trust are what dictate the average size of the grants, rather than their effectiveness. Some funders have noticed that they do this and have reviewed their internal processes.

### Message for funders: staff capacity

It is important to make sure that staff capacity is sufficient to deliver desired grant-making effectively. If there is a mismatch, funders can either change their grant-making—giving fewer, larger or longer grants—or increase the availability of staff to deliver it, either by hiring more staff or freeing time by making processes more efficient (eg, through online applications or more streamlined processes for smaller grants). One practice that funders sometimes fall into, but should be wary of, is giving many small grants to spread risk rather than conducting adequate assessment to give larger grants.

### Diversity

Wanting to have diversity in their grants is an issue that was mentioned by a number of grant-makers. The desire to spread grants around between various charities can be because of several reasons.

### Interest

A few funders mentioned that the minimum number of grants they could give was sometimes driven by the interests of the trust, and sometimes by its mission. For instance, some mentioned that their trust had to spread grants geographically across the country. Others said that they had to cover certain topics of interest, and therefore they had less leeway to make only a few grants. Where giving to a range of interests is important, grant-makers sometimes have to balance what would help charities the most, with the necessity to ensure that the mission of the trust is achieved.

Some trust staff mentioned that the trustees had particular interests that they wanted included in grant programmes. Therefore, the trust funded more charities than it would otherwise. One chief executive said that trustees seemed to ‘horse trade’ amongst themselves—so one trustee would get a particular project funded in return for agreeing

to fund other trustees’ pet projects, leading to the trust making a number of very diverse grants. It is important that personal interests of individual trustees are not placed above the most effective way to achieve a trust’s shared objectives.

### Knowledge of the sector

Some funders mentioned that receiving lots of applications and funding quite a few different charities is a good way to find out what is happening in a sector. This can bring a funder closer to the work being done on the ground. NPC spoke to a few grant-makers with this view who often fund several different activities to get a wider picture and use this to help the sector. This might involve identifying the need for, and funding the creation of, an umbrella body; or holding conferences about ways to improve the sector.

### Risk

Many funders pointed out that if they make grants larger, they would also have to make fewer, which in turn would concentrate the risks onto a few grantees. Sometimes this leads them to avoid making large grants—as they feel they have a desire and a responsibility to ensure that every grant makes at least some difference, and none fail.

Some funders told NPC that they mitigated this risk by conducting more due diligence, for example, by looking at charities in-depth, visiting them and reviewing budgets. One grant-maker that we spoke to said that the trust was aware of the risk of making large grants to charities it did not know well—but that this should be a reason to study applicants more carefully, rather than to avoid making large grants.

Charities often comment to NPC that they like to know that funders understand their work well. They stress the importance of a good donor relationship, including contact and visits.<sup>2</sup>

Not all trusts have sufficient staff to visit lots of applicants, and many have developed other ways to become comfortable with the risk of large grants. For example, some trusts give a small grant to a charity first, and are more likely to give a larger grant in following years once they know the charity better.

But not all grant-makers consider risk in the same way. Some more readily accept that grants will fail, but still consider this money well spent as long as lessons are shared with other grant-makers and charities. One grant-maker

Some grant-makers accept that grants will fail, but still consider this money well spent as long as lessons are shared with other grant-makers and charities.



## If funding is given to a project that is alleviating an ongoing need, is innovation so important?

commented that it felt *'It was ok for things to fail, as long as your intention was good when you made the grant and there was a realistic chance of it succeeding.'* Considering risk in this way means that long or large grants are not barred to grant-makers. It also means that the experience of what does and does not work is shared and benefits the sector as a whole.

### Message for funders: diversity

Achieving diversity in grant-making can be important for some funders for a variety of reasons. Some of these are inflexible, such as when a trust's mission requires it to spread grants across many organisations or areas. If grant sizes or lengths are constrained for these reasons, it is important that they are still appropriate for the activities being supported. New funders should be wary of making decisions about mission or strategy that could create inflexibility and result in constraints on the grants that can be made.

In other cases, diversity is not imperative and in these cases funders need to consider the trade-off they are making when they choose diversity. Giving and receiving smaller grants costs more and can be less effective, so it is important to avoid unnecessarily spreading grants to engage the personal interests of trustees.

Funders may want to increase the number of grants to build up their own knowledge of the sector, and use this knowledge to help organisations in other ways, such as giving funding for specific sector needs. However, the trade-off between gaining knowledge and potentially reducing the impact of grants should only be made if this extra knowledge is used to improve how funding is given.

Another major driver in giving a diverse range of grants is to spread risk. Funders can mitigate risk in other ways, such as extra investigations of applicants and improved monitoring and reporting.

Some funders think of risk in another way. As long as grant-makers have taken due care, there is no fiduciary problem if grants fail. If grant-makers then share their experience of failure, it adds to the knowledge of the sector and benefits other funders and charities.

### Dependency

The risk of a charity becoming reliant, or dependent, on a single funder without diversifying its sources of funding was mentioned by a number of funders that NPC interviewed. Their fear is that when funding is withdrawn, the charity will be left with insufficient money to continue the work.

Some funders have no issue with charities becoming dependent on them and feel that funding new projects is over-emphasised by others. If funding is given to a project that is alleviating an ongoing need, is innovation so important? For instance, the NSPCC's ChildLine provides a confidential listening and counselling service for children. This is an invaluable service, the success of which stems partly from the service's continuity. For children to feel comfortable about approaching the service, it needs to have a sustained and trusted presence. There is clearly a limit to the extent that this service can innovate. To provide a sustained and trusted service, it requires long-term funding.

Grant-makers told NPC that it is important to consider the risk of dependency at the start of funding, and decide whether the trust is prepared to accept that risk. This means that, although it may still be disappointing, it is not a shock to the trust if activities have to stop when the funding ends. The literature suggests that this process of thinking about the potential hazards may actually enable funders to raise their risk tolerance.<sup>3</sup>

Some trusts build in exit strategies to manage dependency. This can involve tapering—providing all or most of the funding at the outset of the grant and reducing the amount given in subsequent years. Tapering is designed to encourage charities to diversify their funding as activities become established. Many grant-makers make sure evaluations of activities are paid for and completed, so that the charity can show another funder the value of its work. To encourage charities to diversify their funding, some trusts part-fund work when they feel the natural funder lies elsewhere, for instance, with local authorities. Some help grantees with fundraising advice, especially less experienced grantees.

### Message for funders: dependency

In many ways, the risk of a negative impact on a grantee when funding is withdrawn is the converse of the positive impact when funding is given. Funders have to balance these two issues, and consider the risk of dependency at the start of the grant. If dependency is thought to be an issue, instead of reducing the size or length of the grant, funders should try to build in appropriate exit strategies to help charities. Dependency is not therefore something to be avoided by funders, but instead managed so that it is less of a problem.

### Attributing impact

While it is important to give funding that is appropriate to the need, it is easier to identify and attribute the impact of larger, longer grants.

One way that some trusts think about attributing impact is in terms of instrumentality—how likely is it that this work would have happened without this grant? One trust that spoke to NPC only funds activities that otherwise would not have happened. This means that the trust shies away from part-funding. If it is one of many funders, it cannot say that the funding was instrumental in the work being done. It would rather make a larger grant so that it can identify exactly what its funding has achieved.

Many funders find that they enjoy funding more when they can point to something that is definitely attributable to them. This encourages them to give more money (if possible). NPC spoke to a few funders that give larger sums for this reason.

### What else do funders consider?

#### Fairness

Sometimes grant-makers limit the size and length of grants so that they can provide at least some funding to a greater number of applicants in the interest of 'fairness'.

But both the literature and NPC's interviews showed that funders increasingly view this type of 'fairness' as an inefficient way to give grants—grant-making without *'counting the cost'*.<sup>4</sup> One grant-maker reflected a view shared by several others: *'Giving £2,000 to an applicant who asked for £20,000 is simply presenting them with a bill for £18,000.'* One chief executive of a grant-making trust commented that she disliked telling a charity that it would receive only part of what it had asked for more than telling it that it would receive nothing at all. This trust has moved away from granting less than what applicants ask for.

A few grant-makers are still influenced by fairness. In our interviews, one way that this motivation was represented was that trusts wanted to raise the proportion of successful applicants by awarding more grants.

NPC recommends that to reduce unsuccessful applications, it is better to examine how guidelines for applicants can be made clearer, more specific and more accessible. As one chief executive commented, *'Funders should tighten the process and system of applications so that you don't have fifteen rejected applicants for every grant.'*

Funders can narrow the criteria for funding to be clear about what sort of charities or activities they are likely to fund. Giving details about the likely size of grants and the general success rate of applications can also help guide applicants. Managing expectations like this can

#### Box 3: Charities—their own worst enemy?

Many grant-makers consider the impact on charities and their beneficiaries when considering the size and length of grants. Yet charities can sometimes be their own worst enemy. In NPC's discussions, both grant-makers and charities raised the fact that charities often second-guess grant-makers, tailoring their applications to what they feel grant-makers will fund. Regardless of the upper and lower limits that the trust sets for grant sizes, charities often look at the average size of grants as a guide to how much to apply for. This is a vicious circle, as it reinforces the average grant size.

Many grant-makers find this infuriating, especially if they are trying to give large grants. Some grant-makers simply give charities what they have asked for, even if they suspect that the budget has been deliberately reduced. However, this may mean that the funding is not used as effectively as it could be.

Some trusts go back to the charities and ask them why they submitted a low application and invite them to submit a higher one. Other trusts make their wishes very clear on their website, including putting up case studies of the larger grants they have given. Other grant-makers signal that they want to give a range of sizes by having different programmes, ie, a small grant programme, a medium one, and a large one.

Charities can improve their funding by applying for the full amount they need, and not changing their application to suit what they think funders want.

reduce unsuccessful applications, benefiting funders and charities.

Paradoxically, when grant-makers ask charities about whether they prefer the trust to make a greater number of smaller grants, or fewer, larger grants, charities often say that they would prefer the former. While this is entirely understandable from the charities' point of view—it means that they have a higher chance of obtaining some funding—it should be interpreted with caution (see Box 3).

A requirement of some grant-makers is that charities cannot apply more than once or twice in a given period, or that there must be a gap of a few years before a charity can reapply. This rule is sometimes attributed to a desire for fairness and sometimes to a desire to avoid dependency. One charity that NPC

#### Box 4: How the wrong grant duration affects beneficiaries

NPC has seen many charities over the years where the size or length of funding has not been sufficient for the outcomes that either the charity or the funder wanted to achieve. One such charity works with refugee children in schools to give them intensive help to improve their grades.

The work is delivered by volunteers, recruited by a volunteer coordinator. The volunteer coordinator was funded for two years, but then the funding was not renewed. The volunteers that had been recruited continued to help the children, but through natural attrition the numbers fell. This meant that some of the children ended up without support, and no new refugee children coming into the area could be helped. So the children who no longer had a volunteer did not improve by as much as the children whose volunteer continued. If the grant-maker had funded the coordinator for longer, she could have continued to recruit volunteers so that the grades of all the beneficiaries improved.



**Box 5: Can grants be too long?**

In this report, NPC argues that too often funders make shorter grants than they should. But are there circumstances when grants can be too long?

Some grant-makers have offered longer grants and been surprised when they were not popular. The Big Lottery Fund offers a range of funding options; grants can be between one and five years. The evaluation of one of its programs, Reaching Communities, shows that 43% of charities applied for three year funding while only 36% applied for five year funding. The Big Lottery Fund thought possibly that charities felt it was easier to plan over three years rather than five years. Another grant-maker also found that its charities requested three years in preference to longer funding. Charities said that they preferred the relationship with the grant-maker brought by shorter, but repeated, funding.

Many funders argue that if you are alleviating ongoing need, long-term funding is appropriate because the need will probably still be there in ten years' time. Others think that even if funders are reasonably certain that the need will still be there, other factors may intervene. There may be a new intervention that works better, or the charity may change. What might be the most effective use of money now may not be in several years' time.

It is therefore important that long grants are well structured with break clauses in case something changes either within the charity or the sector. Unrestricted funding (see Chapter 2) may mean that the charity can respond to changes more easily. If a new method of tackling the problem comes along that is better, then the charity can adopt that, and the funder's money is not wasted. In theory, given that many grant agreements do have break clauses, there is little to stop grant-makers from signing up for longer.

NPC has seen many charities that have been hampered in their work because of the wrong size or length of funding.

talked to was funded to examine best practice in an important but specialist area of palliative care. During the initial grant period, the charity made excellent progress—greater than was expected—and so was keen to extend the grant so that it could capitalise on its success. Unfortunately the grant-maker's policy meant that it was unable to fund the charity for two consecutive grant periods, so it is likely that the charity will have to suspend work. As one grant-maker commented, *'This does not manage dependency, but just transfers it.'* And it often means that good work cannot continue in the same form, thereby not being fair to the beneficiaries.

**Tradition**

A few grant-makers said that the size and length of their grants is influenced by tradition. NPC heard a few comments from grant-makers that they gave a certain size of grant because *'We've always had a small grants programme.'* However, other grant-makers had reviewed their policies in the light of what was most appropriate for the sector they fund.

**Trust**

What if the grant-maker suspects the budget for an activity is too big? One grant-maker that we interviewed tries to address this by giving

such cases a small grant to undertake further scoping first. A charity can then either come back with a reduced budget, or with proof that the work needs the original amount of money. This is a good way to ensure that budgets are appropriate.

Other grant-makers give charities less than they ask for when they suspect this, without further consultation. However, if the suspicions are ill-founded, then this may expose charities to the pitfalls of small funding if the grant-maker is wrong.

**Message for funders**

Many grant-makers consider applicants to be their stakeholders and therefore like to be able to fund as many as possible out of a sense of fairness. However, this can inadvertently end up hurting charities and damaging the effectiveness of their funding. Funders should check periodically how the types of grants they give match with their funding aims to avoid being unduly influenced by tradition. Where funders suspect that charities are asking for too much money, they should avoid scaling back grants without first consulting charities about their costing.

**How can the wrong size and length affect charities and beneficiaries?**

When considerations other than effectiveness stop funders from giving the appropriate grants to charities, funding can have a reduced or negative impact. NPC has seen many charities that have been hampered in their work because of the wrong size or length of funding (see Box 4).

**Small amounts of funding can reduce effectiveness**

Unless a charity is already expecting to get the balance of the money it needs for an activity from elsewhere, awarding part of what it applied for can increase the fundraising costs, and delay the project start. Alternatively, if the grant is funding a post, the postholder funded by the grant may spend the first few months of his or her work securing the remainder of the funding from elsewhere or may be reduced to a part-time role. This limits the pool of people that will apply for the job, and may reduce the quality of charities' staff. One part-time charity worker that NPC talked to felt that the administration involved in her job did not decrease proportionally with fewer hours. Therefore she currently spent a large proportion of her time on administration. She felt that if the grant-maker had funded her full-time, then it would have increased her capacity for working with service users by 150%.

If funders scale back the grant from the amount a charity requests, it can indirectly affect the

viability of the charity. The Baring Foundation conducted a review of the grants that it had given over a decade. It found that nearly three quarters of these grants had been for a lower amount than requested, and one of the ways that grantees coped with having less funding was by scaling back the projects.<sup>5</sup> If funders have to scale back funding, it is important to make sure that the project can actually be scaled back. Otherwise, the most likely thing to be cut will be overheads, which strains the entire charity.

### Too big can be as bad as too small

Charities may not have the capacity or experience to absorb large grants. For example, funders sometimes give transformational grants of a multiple of a charity's income. These transformational grants often require organisations to become more professionalised, which may not be in tune with the needs of clients or what the organisation is ready to do.<sup>6</sup> Alternatively, a charity may not have the management and processes in place to do much more than meet modest goals. If a large grant comes along, the charity may not have the leadership in place to meet the targets that come with a larger grant.

Interestingly, NPC heard in interviews that giving big grants alone can deter charities from applying for funding. Charities worry that they will not receive a small grant and that a large grant may have a detrimental impact on them. Similarly, charities can be deterred from applying for longer grants (see Box 5).

### Short-term funding may have a negative effect

Short-term funding can be detrimental. Funding staff posts for a short time is especially damaging. Charities told NPC that only having funding for posts for one year affects the quality of applicants they can attract, and undermines job security. Staff may have to spend time applying for new grants that they would rather spend on service delivery. Some charities even said that short-term funding and funding that gets renewed at short notice has forced them to break employment law.<sup>7, 8</sup> One charity chief executive told NPC that *'Some funders exploit the commitment of charity staff.'*

The literature shows that short-term funding can also directly affect beneficiaries. In areas like mentoring, counselling, or work with vulnerable people, ending a service can leave clients feeling abandoned, and even reverse their progress. An Amicus survey of its members in the voluntary sector found that two thirds thought that short-term funding resulted in a reduced service to clients, and had a detrimental result on service provision.<sup>7</sup>

### Box 6: Retired and Senior Volunteer Programme

A number of the charities that NPC has analysed have encountered problems with the size and length of funding they receive. Retired and Senior Volunteer Programme (RSVP, part of Community Service Volunteers) is a project that helps older people get involved with their community through volunteering. This is rewarding for the volunteers who can be isolated and lonely and it also has a positive impact in their community.

Because RSVP works with volunteers, sustained funding is important—it can take a long time for projects to get up and running. For grants that are three years or less, RSVP's ability to develop projects, demonstrate their impact and evaluate them is limited. A typical three-year funding cycle might look like this:

- 1st year: funding secured. First 12 months are spent recruiting suitable volunteers and staff for the project, developing and promoting the project for launch, doing Criminal Record Bureau checks etc.
- 2nd year: project is running.
- 3rd year: final year, project starts to wind down. Volunteers and staff turn attention away from running the project to securing more funding and developing volunteer managed systems.

Five year funding for these kinds of projects would be more beneficial. It would give the charity enough time establish the project, run it properly for a number of years, develop a cadre of volunteers who will provide sustained management of the project in the future, and then carry out a full and thorough evaluation. This in itself could help secure future funding.

Short-term funding can also compromise effectiveness in other ways. If a funder wanted to pilot a new service, insufficient funding can leave the charity unable to prove that the intervention worked. The effectiveness of the funding is harmed because the charity is not given enough time and the charity itself may also be harmed because the evidence is not available and cannot be used to attract other funding (see Box 6).

Many funders agree that short-term funding can compromise effectiveness. One funder has said: *'Three years' funding may well be too short to make an impact.'*<sup>9</sup>

### Smaller or shorter grants increase administration costs to charities

Charities spend around £350m a year applying for funding from trusts and foundations.<sup>10</sup> This is equivalent to the grants given annually by The Wellcome Trust, the UK's largest independent grant-maker. Charities often need to apply for grants frequently to keep their services going, making small grants relatively more costly than large grants. US research shows that grantees spend more time per dollar on applying for and monitoring smaller grants than on larger grants.<sup>11</sup> Table 1 below shows what they spent.

\* Fundraising ratio for trust income is 8.91. The total amount given is £3.1bn, therefore charities spend £347m on fundraising.

**Table 1: Money raised per hour spent applying—applicants to US foundations<sup>11</sup>**

Grant size (\$)	Average time spent on grant application and monitoring (hours)	Average amount raised per hour of administrative time spent (\$)
10,000	7	1,500
100,000	12	8,500
1,000,000	217	46,000

NPC heard from several funders who described how they have moved from feeling they were funding many things badly to fewer things properly, and have not looked back.

The table shows that smaller grants were the most costly funds to raise. Some funders use simpler application processes for smaller grants. This is important as without such measures, applicants for smaller grants—often small charities—will face higher costs of securing funding. However, it is impossible to make the administrative burden entirely proportional to grant size and so it is likely that smaller grants will always be more expensive for charities to receive.

**Summary**

The size and length of a grant should be driven by what is needed to get the best outcome for those that funders and charities aim to help. In general, the most effective grants support the full costs of the work that charities are undertaking, and are guaranteed, where appropriate, over the period of time necessary for the charity to achieve particular milestones.

Funders often give less money than is needed, and for a shorter length of time, due to internal factors. But giving larger grants could:

- reduce delays for charities in starting projects;
- reduce fundraising costs;
- avoid charities cutting back the quality of their services; and
- reduce funders’ costs of administering the funding.

If funders give longer, multi-year grants, it will reduce administration costs for both funders and charities. In an ‘industry’ where resources are scarce, this is obviously important. Longer, multi-year grants provide stability to charities, enabling them to plan and use their funding more effectively. They may also make it easier for funders to see the impact they are creating.

Grant-makers have limited funding and must therefore find a balance between the number of grants to give, and the size of each grant. A larger number of smaller grants can help to solve a problem from different angles, or sustain many effective ongoing projects. But this should not be at the expense of effectiveness; funders need to provide the right size grants to applicants.

Funders should give smaller grants where this is driven by funding need—where the amount required is naturally small. Funders may also wish to give smaller grants to part-fund activities where they are not the ‘natural funder’ and want to encourage others, such as government, to pick up part of the bill.

The larger and longer the grants, the more funders need to invest in understanding issues and charities. Some funders fear that giving larger, longer grants is ‘putting all their eggs in one basket’, but this can be overcome by making the effort to understand fully the charities that they fund.

The risk of charities becoming dependent on a single funder is another concern, but such dependency is a natural feature of funding relationships and is unavoidable. When giving large or small grants, it is good practice to think about what will happen at the end of the funding period. Assessing risks at the outset and making informed decisions can avoid unexpected failures.

Two other factors that NPC heard about, which affected funders’ decisions, are tradition and fairness. If funders do not review their funding practices regularly, they will not match to the needs they wish to fund. It is important to be wary of giving a larger number of grants to avoid turning charities down, out of a sense of fairness. Ultimately, NPC heard from several funders who described how they have moved from feeling they were funding many things badly to fewer things well, and have not looked back.

# Restrictions

Funders, generally, give to achieve specific outcomes—this often leads them to place restrictions on the purposes for which charities can use the funding. The most common reason to restrict grants is to ensure that funding is used for specific aims, which may not be the same as the charity’s aims. Yet sometimes funders restrict their funding unnecessarily.

Unrestricted funding makes it easier for charities to be flexible, responsive and find new ways to improve beneficiaries’ lives. Therefore, using restrictions only where necessary helps charities achieve their outcomes. Where restrictions are needed, they should be as ‘loose’ as possible to meet funders’ needs while granting charities as much flexibility as possible.

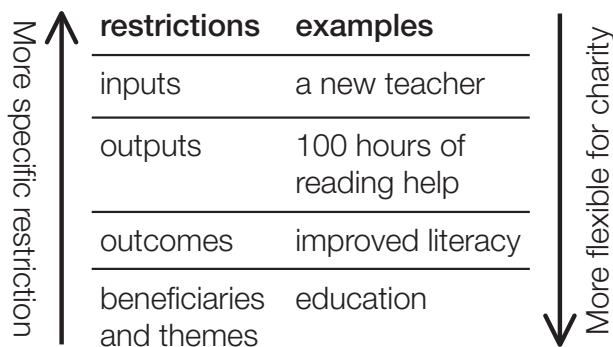
Although funders often see the decision to restrict as a product of other decisions, this chapter aims to show why it is an important consideration in itself. It challenges whether restricted funding should be the norm, and suggests a framework for considering when it is appropriate to restrict and when it is not.

## What restrictions are placed on grants?

When funders specify what the grant can be spent on, it will typically be done in the grant agreement. These restrictions can be determined either by what the charity requested funding for, or by what the funder wants. Funders place restrictions on charities because they want them to achieve certain outcomes and funders want to be instrumental in achieving those outcomes. There are a variety of levels of restrictions that can be placed on grants, some more onerous than others. Restricting a grant to the NSPCC to cover only its work with children is hardly a restriction at all. Similarly, restricting grants towards an organisation’s running costs is not generally a problem. Other restrictions can be much more limiting.

Figure 2 shows the types of restrictions in the order of how onerous they are to charities.

Figure 2: Different restrictions have different burdens



As Figure 2 shows, restrictions are not binary. Instead, there is a spectrum, with different implications for grantees. This often gets overlooked, and has not been much explored in literature on grant-making.

This can be illustrated by the subject of child literacy. A funder might be motivated to help children read, and therefore limit the funding to beneficiaries and themes. Or a funder might want children to improve their literacy by a certain amount, and therefore restrict it to outcomes.

**Box 7: 'Direct costs', 'overheads' and the importance of full cost recovery**

The acevo and NPC report, *Full cost recovery: a guide and toolkit on cost allocation*,<sup>13</sup> defines direct costs and overheads as follows.

**Direct costs.** Costs incurred in producing the output of a particular project or service itself. For example, the salaries of people working directly on the project, their travel and subsistence, materials and costs easily identifiable as part of the project. Also referred to as project costs.

**Overheads.** Costs that cover such things as premises and offices, central functions, governance and strategic development, general fundraising, staff training and marketing. Such overhead costs are often interchangeably referred to as core costs, or indirect, central, support, operating support, infrastructure support, general purpose support, management or administration costs. A report by Grantmakers for Effective Organisations states that grants to cover these costs are given in support of a charity's mission rather than for specific projects or programmes.<sup>14</sup>

When the report was written in 2004, the chief executive of acevo said that *'The core/project distinction is artificial and increasingly obsolete.'* However, while we were researching this report during 2008, we found that the distinction between 'project costs' and 'core costs' was still firmly part of the lexicon of both charities and funders.

**Full cost recovery.** Charities may have difficulty funding overhead costs, as funding is often restricted to project costs. This problem is compounded if the full cost of such projects is not fully funded. While many charities are trying to ask for funds to cover the full costs of their projects, some funders are still not receptive to paying for overheads. The debate about full cost recovery has come a long way in recent years, but not everyone is completely signed up to the issue. Many charities still underestimate their cost base, and many funders, while willing to fund some of the central costs, are not willing to fund them fully. Depreciation and mortgage costs are items that some funders still refuse to fund.

This has consequences: to quote *Full cost recovery* once more, *'Having only some of your overheads covered presents a serious problem: having none covered means your organisation will almost certainly fail.'*

Sometimes funders aim to fund specific interventions, and therefore restrict funding to outputs or inputs, for example, to 100 hours of reading help. This means that a funded charity would not be able to use the grant to achieve the desired outcome of improved literacy by other methods.

If, instead, the grant is loosely restricted to an outcome (improved children's literacy), then the funding could be more effectively or efficiently used to conduct research into new interventions, or to train volunteers to coach children, or to organise breakfast clubs at schools—all of which might help to improve children's reading skills. If it is restricted to the theme of improving educational outcomes, the charity could use it to help truants if it believes truancy is a major cause of poor literacy.

Funding inputs can take a number of forms—funding only the direct costs of an activity (eg, a salary and the direct overhead costs) or restricting the funding so that it does not pay for any overheads at all.

Funders may also make restrictions by exclusion, for example, not funding a charity's campaigning work.

Charities rate different types of income differently depending on how restricted it is. Respondents to a survey on unrestricted funding said: *'I see unrestricted earned income as most valuable "Grade A" (unless it gives us VAT problems); I see unrestricted grant income i.e. "core funding" as next most valuable "Grade B"; Vaguely Restricted income i.e. tied to a general work area with Full Cost Recovery "Grade C"; Tightly restricted to a specific project but with Full Cost Recovery "Grade D" and anything else as not worth applying for!'*<sup>12</sup> Box 7 explains these terms in more detail.

### Funding for general overheads is usually unrestricted

During research interviews, NPC noticed that most funders and charities consider funding for overheads, or 'core funding' to be synonymous with unrestricted funding. This is usually the case in practice, because unrestricted funding is often used for infrastructure rather than service delivery. For simplicity in this report, we shall use 'core support' synonymously with unrestricted funding. Similarly, when we refer to 'project funding', we mean restricted funding for a particular activity.

### Terms and conditions of grants

Even grants that are not restricted may have certain terms and conditions placed upon them. An example of such a condition is that the funds must be spent within a specific timeframe (often within six months or a year).

Funders may also have negotiated an agreement with a charity covering how an unrestricted grant will be assessed or reported; this is not the same as having restricted the grant.<sup>14</sup> For more information about reporting to funders, refer to NPC's *Turning the tables* reports.<sup>15,16</sup>

### Why are restrictions an important issue?

Donors need to be aware that restrictions can sometimes have a negative impact on charities. Restrictions may make it difficult for charities to innovate and try out new approaches, or be responsive to unexpected events. Restrictions are particularly problematic if they are tight and inflexible. When funders place restrictions on grants, they should consider whether they are hindering their grantees from achieving their objectives.



## What factors do grant-makers take into account?

According to NPC's conversations with grant-makers, most funders restrict grants. This is broadly similar to research from the US, which found that nearly half of foundation chief executives always prefer to restrict funding to projects or programmes of activities. Around a third of chief executives have no systematic preference for restricting programmes, and only 16% prefer to give 'operating support'.<sup>17</sup>

NPC heard many reasons why grant-makers restrict grants, including:

- to ensure that charities deliver the donor's mission;
- to help donors to report to stakeholders, monitor impact, evaluate and attribute their grant;
- to avoid reputation risk;
- to alleviate dependence by the charity on the donor;
- because funders do not know the charity well enough;
- to influence charities; and
- because charities apply for restricted funding.

Some of these factors are of particular concern to trustees of foundations (see Box 8). The rest of this chapter will explore these factors in detail, drawing on the discussions NPC held with experts and grant-makers. Our aim was to find out: whether the factors that were suggested in the literature about why funders restrict their grants were the factors that funders actually took into account; and how some donors manage to balance their own needs with those of charities and the people the charities are helping.

### Funders restrict to ensure charities deliver the outcomes the funders want

#### The best result comes when donors' and charities' aims are aligned

Most grant-makers give funding with specific aims in mind. Grant-makers told us that alignment between their goals and the work of the charity was an important consideration in deciding whether to give unrestricted funding. Donors prefer to fund charities that match their aims, and when they do, they often find it easier to give unrestricted funding.

If the charity's and the donor's aims are the same, then unrestricted funding is very useful. Since the charity is closer to the beneficiaries,

#### Box 8: The influence of trustees on grant structure

Trustees are often highly regarded people who bring a wealth of knowledge to grant-making, and in most cases make the decisions about grants, including size, length and restrictions. They are generally concerned about governance responsibilities (reputation risk, fiduciary risk), and being able to account for the money that has been spent.

For these reasons, in some cases that NPC came across, trustees put pressure on their staff to limit the size and length of grants and place restrictions on grants to reduce the risk in any one organisation.

However, trustees may not have much detailed experience of grant-making or of particular charity sectors. Therefore guidance from knowledgeable staff and relevant research should guide trustees towards making the best decisions to achieve their outcomes. Where this guidance does not exist, trustees feel the need to influence how grants are made. For instance, research from the US suggests that trustees are reluctant to support unrestricted funding; executive directors overwhelmingly favoured operating support but said their boards would be less supportive of the concept.<sup>14</sup>

In order to avoid these problems, trustees could consider:

- devolving authority for giving grants (for even significant sized grants) to their staff and monitoring the impact of these grants closely;
- becoming familiar with the principles of good grant-making from other funders through sharing experiences and literature; and
- visiting more charities to gain a better picture of the impact that the structure of grants can have on charities.

it is well placed to judge if there is a better way of achieving the same outcome. Unrestricted funding means that it can act on this, without going to the trouble of getting the restriction changed, or needing to apply for more funding. This means that the funder is more likely to get the outcome that it wanted.

#### Restrictions can be used to manage mission mismatch

When donors' and charities' aims are only partially aligned, restrictions often come into play. For example, a donor that funds children's mental health might not be interested in providing unrestricted funding to a women's domestic violence charity. But it might choose to provide a restricted grant to fund the charity's counselling sessions for the children of abused women.

The aim of some donors is to work with charities to help them to make a step-change. One such donor told NPC that this led them to make restrictions: *'Restrictions enforce [our] opinion onto the grantee, although the grantee will have agreed to that. It is not just about confidence in management—otherwise, if a grant-making trust is funding something that does fit with its mission, it should give unrestricted funding. If you don't trust management why are you giving them a grant in the first place?'*

If the charity's aims and the donor's aims are the same, then unrestricted funding is very useful.

A US study by the Center for Effective Philanthropy found that 20% of foundations prefer giving project funding to ensure fit with their mission.<sup>17</sup>

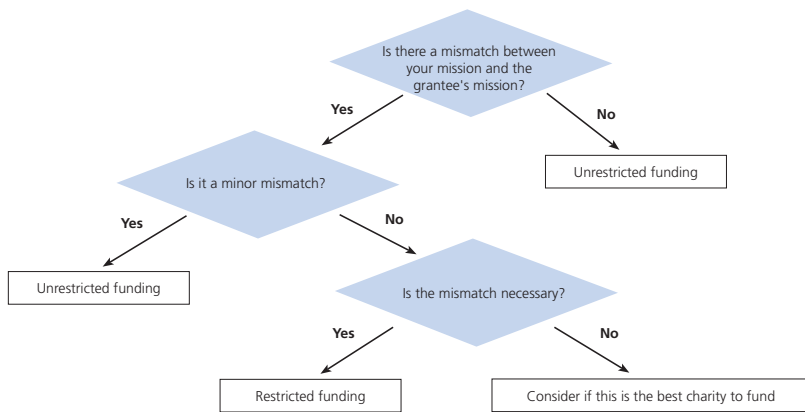
**How do grant-makers deal with mission mismatch?**

The literature suggests that unrestricted funding should be the default position for grant-makers, even when their aims are not perfectly aligned with their grantees' aims. In one report, a grant-maker said: 'Granting that there are many situations where funder and organisational interests only coalesce around particular projects, funders should nonetheless have a presumption in favour of negotiated general operating support.'<sup>14</sup> Even when there is mission mismatch, the preferred position should be for unrestricted funding.

Restrictions do make it easier to report, but that shouldn't be a basis for deciding about funding.

A funder

**Figure 3: Mission mismatch and restrictions**



For example, one foundation told NPC: 'If an organisation which is wholly within our area of need wants core costs, we are happy to give that. If, however, the charity's mission is different from ours, then we do have to place a restriction.' This foundation does not normally fund environment charities, but is interested in refugee volunteering programmes. Consequently, it gave restricted funding to an environment charity's refugee volunteering programme. Since this foundation tries to give unrestricted funding where possible, if it does give a restricted grant, it tries to ensure the restrictions are not burdensome. So, the charity is restricted to the outcomes it suggests itself, rather than to specific inputs, such as a particular staff position.

**Message for donors: matching mission to charity's mission**

Where a charity's and a donor's mission completely overlap, unrestricted funding is preferable.

Where the missions only partly overlap, then a donor might need to restrict funding to a beneficiary group or outcome or activity. Care should be taken not to restrict funding overly, ie, by restricting the grant to an input or a budget line item. Figure 3 illustrates these options.

The impact of restrictions can depend on perspective: they might increase the impact the money has in delivering the donor's objectives, but may reduce the capability of the charity to best allocate resources to achieve its own objectives.

**Funders use restrictions to influence reporting, evaluation and attributions**

**Reporting and evaluating unrestricted funding can be more complex**

Some foundations place restrictions on their grants because they believe that this makes it easier to report what was achieved with the funding. This may be true but, as one foundation told NPC, 'Restrictions do make it easier to report, but that shouldn't be a basis for deciding about funding.'

The Center for Effective Philanthropy found that 30% of foundations say they prefer project funding because outcomes are easier to identify.<sup>17</sup>

Grant-makers that usually provide restricted funding often said that unrestricted funding was too hard to monitor: 'Unrestricted grants make it harder to see where our money is going; therefore we tend to fund capital projects. The management of unrestricted grants seems more complicated, and reporting back to trustees is harder if the grant is unrestricted.'

This is a view shared by some charities as well: 'Restrictions make it much easier to report. With unrestricted reporting I have to choose between which of the thousands of projects we did this year to write about.'

Foundations that give unrestricted grants do not perceive the same problems. They often monitor the outcomes of the whole organisation, or set objectives for the grant and then monitor those. 'We look at the impact the whole organisation has achieved.' The review of the Execution Charitable Trust's grant-making, *Trading for the future*, shows how this funder recognises its contribution towards a charity's results as a whole rather than insisting on the results of its funding being separated out.



In fact, unrestricted funding may help charities monitor their outcomes. Research from the US shows that unrestricted funding can be the catalyst that helps charities think about the outcomes of their work. Instead of concentrating on part of the organisation, the focus broadens to the whole charity. The charity may have to think about whether it is delivering on its mission; does it run effective programmes or is there a better way to serve its beneficiaries?<sup>14</sup>

In NPC's *Turning the tables* reports, a standard report that monitors the outcomes of the whole organisation was piloted (see Appendix 3). Funders who are unsure about how to monitor outcomes for the whole organisation could use this.

### Attributing unrestricted funding can be less obvious

Foundations often want to know what their money has achieved. They want to be reassured that their money has 'done something' by pointing to a specific programme.<sup>18</sup>

Indeed, some foundations told NPC that they restrict funding because it makes it easier to attribute a charity's results to the funding that the foundation contributed. This may well be the case, but is hardly a firm basis for effective funding.

One foundation that regularly provides unrestricted funding likens it to being a shareholder in the whole organisation. The trustees say that they find it more satisfying to have a stake in the impact of the whole organisation, rather than just one aspect of its work.

### Governance risk and legal issues

Some funders felt that their fiduciary duty as grant-makers contributed to a need to restrict funding. For example, NPC spoke to a funder who felt that giving unrestricted funding runs counter to fiduciary duty, because it is difficult to be sure that funding will be used in accordance with charitable purposes. By restricting funding, funders can demand that a charity reports on exactly what the money was spent on.

However, many funders that give unrestricted funding did not share this concern.

### Message for donors: reporting, evaluation and attribution

Some funders still restrict grants to inputs (where the money went) and ask charities to report back on those inputs. Many funders restrict grants to outputs (what the charity did) and then ask charities to report back on those. In NPC's opinion, time spent by charities extensively documenting inputs and outputs or

duplicating information for different funders is wasteful for charities and should be minimised, unless, for example, this data is a necessary input to other research or an evaluation.<sup>15</sup>

NPC has long been an advocate of measuring a charity's outcomes as well as measuring its inputs or outputs. In other words, charities should measure what impact was made on people's lives, rather than how much the charity spent or what activities it undertook, or how many people used its services.

Reporting on outcomes lessens the compulsion to make restrictions on inputs and outputs. Whereas reporting on restricted funding is often perceived only to be for the benefit of the funders, unrestricted funding allows the charity to look at what information it needs to evaluate its impact, improve its work, decide how to allocate resources and report to all stakeholders. Doing this well will improve all aspects of charities' effectiveness and efficiency. NPC will be developing guidance and tools to help charities achieve this.

### Funders use restrictions to manage reputation risk

NPC spoke to some funders who worried that if funding was unrestricted, it could be used for something that would reflect badly on the foundation. These funders are understandably concerned about their reputation. Perhaps they are granting money raised through a public fundraising campaign, or are accountable to parliament, or are a corporate foundation that does not want to damage the corporate brand. These funders restrict so that the charity cannot use the money for a purpose that they do not approve of.

Managing reputation risk through restrictions may not always work. If a funder gives a grant for a particular activity, and the recipient charity does something else that would reflect badly on the funder, it is unlikely that the risk would be contained. In fact, using restrictions as a form of insurance like this might be a risk in itself, since funders may not adequately review the risks of the whole organisation.

#### Box 9: Porticus UK

Porticus UK is a philanthropy advisory charity that makes recommendations to its associated trusts on four areas in the UK: strengthening family relationships; enriching education; church renewal (Roman Catholic); and ethics in practice.

Porticus UK tries to counter dependency as much as it can through prioritising pilot programmes, and is committed to raising the profile of certain grant-holders through events, including dinners and workshops. It also uses independent evaluations for its own learning as well as giving charities a useful tool for further fundraising. Porticus UK thinks about ways to improve the fundraising skills of the charities that it supports. Fundraising training, strategy and marketing, and leadership courses have been offered to grant-holders.

Unrestricted funding can be the catalyst that helps charities think about the outcomes of their work.

Exiting is a normal part of the grant-making process and should be built in from the start.

Core support promotes accountability by stressing the destination—social impact—more than the path a grantee takes to get there.

A funder

Other funders feared that giving unrestricted grants to organisations would lead to allegations that they favour one charity over another, and that this might be a risk to their reputation. These funders believe that by funding only certain activities, they make it clear that they are only making judgements about interventions and not about organisations as a whole.

#### Message for donors regarding reputation risk

Funders may have good reason to be sensitive about their reputation and may restrict funding in an effort to manage reputational risk. However, this does involve a trade-off between what is best for the funder and what is more likely to achieve the best outcomes. Ideally, funders should try to restrict at the highest possible level they can to minimise the impact on the charity's work. Despite these precautions, restrictions might still not protect a funder's reputation.

#### Funders use restrictions to manage dependency and exit strategies

##### Unrestricted funding can create greater dependency

Dependency can be a particular problem when providing unrestricted funding. If there is little negotiation between a funder and a grantee at the start of an unrestricted grant, then the funder may be unsure what the money will be spent on. This means that the funder may not know what would be a suitable point for exiting, and the grantee might not be sure how long it should expect to be funded. Because it is harder to attribute unrestricted funding, funders may also find it difficult to judge what will happen when they do exit. Will a project have to end, or will the whole charity suffer?

The grant-makers that NPC interviewed did think that unrestricted funding created more dependency. One foundation said: *'Unrestricted or core funding doesn't have a logical ending point, and therefore it is harder to withdraw it. We would get negative coverage if [we] withdrew unrestricted funding and then the charity got into [financial] trouble.'*

However, the literature suggests that trying to solve dependency by restricting funding is unrealistic: *'By definition, grantees are reliant upon our resources, and unless they create a self-generated revenue stream, their dependence on you will just be transferred to another funder.'*<sup>14</sup> Some of NPC's interviewees agreed: *'Dependency just shifts from one trust to another.'*

##### Using exit strategies to manage dependency on unrestricted funding

Dependency does not have to be managed by restricting funding. Various literature from the

US says that dependency is better managed with plans devised at the beginning of funding about the best way to end it.

Many grant-makers agreed that exit strategies like these should be planned from the outset of a grant and discussed with grantees, as part of standard grant-making processes. *'The best kind of exit is built on "thinking upfront" about what a grant or program is intended to accomplish.'*<sup>19</sup>

Many foundations, including Porticus UK (see Box 9), told NPC that they offered charities help in finding other funding, such as paying for courses on fundraising. Others make sure that they always pay for evaluations so that charities can prove the value of their work to other funders.

#### Message for donors about dependency

Donors who are concerned about dependency do not necessarily need to restrict funding to counteract the problem.

Funders should think about dependency and exit strategies at the start of the grant and properly consider what risks they are happy to take. If they believe that dependency will be an issue, steps can be taken to alleviate it, such as sharing a charity's results with other potential funders.

Donors could encourage charities to become sustainable. This might be by increasing their earned income stream, making better grant applications, or training or funding a fundraiser. One foundation's funding was used to employ a fundraiser to attract capital funding for the development of new premises. For a cost of £72,000 over three years, this fundraiser achieved new income of £2.5m—a startling return on investment of 3,400%.<sup>2</sup>

#### Funders restrict because they do not know the charities well enough

Many grant-makers told NPC that in order to give unrestricted funding they would have to know the charity very well. Understandably, they want to be assured that the charity will make good decisions about where to spend the money, and that it has systems in place to ensure accountability and transparency. Clearly, grant-makers who give restricted funds also want to know this, but the bar can be much higher for unrestricted funding.<sup>14</sup>

#### Grant-makers may not have the capacity to get to know charities

During this research, grant-makers frequently commented that their own capacity was a barrier to unrestricted funding: *'If you are going to give unrestricted core funding, you need to have a lot of confidence in and understanding of the organisation. That puts quite a burden*

on the grant-giver. It very much depends on the capacity of the grant-giver.'

Grant-makers that have both the appetite and resources to become very familiar with a sector, and with potential grantees, find it easier to give unrestricted funding. One grant-maker (which gives around a quarter of funds as unrestricted grants) has the resources to visit charities both before and after making grants, and to be widely engaged in the sectors that it funds. The chief executive told NPC that this engagement enables the trust to give unrestricted funds. The foundation does not have unlimited resources; only charities that seek grants over £5,000 receive visits, not those applying for lower amounts under its small grants scheme.

NPC's interviews with charities and grant-makers frequently featured comments about trust and honesty. One charity told NPC: *'The more you involve a funder in your work, showing you are fulfilling a need and doing it professionally, then the more likely they are to trust you and give unrestricted funding.'* One foundation programme manager agreed. He builds up trust by visiting charities, speaking with the chief executive and undertaking a due diligence process.

### Grant-makers may not have the right processes in place

Some grant-makers may have enough staff to get to know charities, but for various reasons their processes may still inhibit this. One grant-maker said that it never phoned or visited charities (except in the case of very large grants) because it felt it would be unfair to visit only some of them. Other grant-makers may concentrate on dealing with applications rather than assessing charities. Changing their processes might make more time available to visit, allowing them to go through the charity's plans.

Clearly grant-maker processes need to be best adapted to give away grants most effectively. These processes will vary depending on what the funder wants to achieve, and this report does not deal with this in depth.

### Message for donors: get to know charities

NPC's research indicates that grant-makers feel that the barriers to unrestricted funding are lowered if funders know the sector well, and can form relationships with potential grantees.

Visiting charities to get to know them better is clearly beneficial. If staff capacity is an issue, funders can elect to visit only those charities that are seeking funding over a certain amount. Or they might try to reduce the number of applications received so that they can concentrate on assessing more appropriate applicants.

## Funders use restrictions to influence charities or sectors

Some grant-makers told NPC that they used restrictions to influence charities. Grant-makers sometimes worry that unrestricted funding allows charities to keep doing what they are doing, rather than asking the 'bigger questions' about the systems in which they work, and that this perpetuates the status quo.<sup>14</sup>

Some foundations told NPC that they believed that *'Restrictions that aren't too onerous can help charities to plan how they are going to spend the grant properly.'* In NPC's experience, this is not always true. Plenty of plans for restricted funding are not well conceived or underpinned by sound business plans or management accounts. Charities that have to restrict money to certain projects can artificially ascribe money to certain items. One funder commented that this was especially true when the money was a large proportion of the charity's budget. Conversely, many charities plan and budget meticulously for spending unrestricted income.

Some funders will insist on restricting in certain circumstances to help the charities they know. One funder occasionally has grantees that it really likes, but feels they need to concentrate on infrastructure rather than on service delivery. It will therefore restrict the money to, for instance, a finance director. This is the model that venture philanthropists use. It works well when the funder knows the charity well and engages in a dialogue with it about what it needs. However, if the level of knowledge is lower, and a funder is simply trying to tie a charity down in a particular way, then restricting funding can have a negative impact.

Some donors try to encourage charities to work together to achieve particular aims. This can work superficially, but many people question whether it is really effective in the long run. One charity NPC spoke to said: *'There is an assumption by funders that they will get more for their money, but a lot of work and money is invested into sustaining the partnership at the expense of delivering the services. Partnerships do not always match very well.'* Partnerships that have been instigated by charities are felt to work better than partnerships that have been imposed through restrictions.

There are times when unrestricted funding can actually be more influential on a sector. Giving charities the flexibility to adapt to new circumstances, and the ability to invest in their infrastructure, may make them more responsive. The LankellyChase Foundation is an example of a funder that decided to give unrestricted funding to invest in a sector's infrastructure (see Box 10).

Grant-makers that have both the appetite and resources to become very familiar with a sector, and with potential grantees, find it easier to give unrestricted funding.

### Box 10: The LankellyChase Foundation

One of the areas that the LankellyChase Foundation supports is offenders in society. For many years now, the foundation has provided extended support to charities helping prisoners and their families. This has included funding evaluations, and providing information and networking opportunities to strengthen small to medium sized organisations. The LankellyChase Foundation observed that many organisations within this sector were in very vulnerable positions with low levels of reserves. It therefore decided that it would be willing to give unrestricted funding in this field, so that the charities would have the opportunity to grow and develop.

#### Message for donors: influencing charities or sectors

Funders should make sure that they have solid reasons for using restrictions to influence charities. Restrictions can have positive effects, but can also have unintended negative consequences. In many cases, unrestricted income will be better for charities.

#### Charities may deliberately seek restricted funding

NPC's interviews revealed that while restrictions are often set by donors, charities also place restrictions on themselves when they apply for grants.

One foundation interviewed often makes unrestricted grants, but many charities apply to it seeking funding for specific projects. In the past, foundation staff have contacted some of these applicants to encourage them to apply for unrestricted funding instead. Given that restricted funding can be a problem for charities, it seems curious that charities are deliberately seeking restricted grants.

#### Charities are trying to improve the odds of receiving funding

The evidence presented earlier that there is simply more funding available for project and capital purposes than for general overheads, suggests that charities are behaving rationally when they apply for restricted funding.

One charity chief executive said: *'We always look through the criteria and think what are they likely to buy. We adapt the size, length and the projects to fit in with their restrictions.'*

In the current funding market, charities are prudently seeking to maximise their chances of receiving grants. If more funders were prepared to give unrestricted funding, charities might feel they had less need to apply for restricted funding.

#### Charities like to leverage project funding

Charities also told us that, by applying for part-funding for a particular project, they can

'leverage' that funding and ask other funders to contribute to the same project as well, thereby improving the chances of fully funding the project.

Once more, the current funding market contributes to the need for charities to cobble together their financial affairs in this way. Leverage might not be such an issue for charities if more funders gave full consideration to the size and length of grants.

#### Charities find it easier to get funds for pilot projects than for ongoing work

NPC also heard that charities find it easier to get grants when they are piloting approaches to tackling problems, rather than when they are continuing existing activities.

In NPC's discussions with many charities and funders over the years, it appears that charities sometimes reinvent existing work to appear more innovative and to get restricted pilot funding. Artificially structuring activities in this way is hardly efficient.

#### Sometimes charities prefer the inflexibility

One positive consequence of restricted funding that was mentioned by both funders and charities is that it can give management 'strategic inflexibility'. In other words, if management can say that money is earmarked for specific purposes, potential funders are more likely to give the charity money, instead of insisting it uses current funds. This can be useful if a charity is saving up for something unusual, for instance, to pay for a new building.

#### Message to charities

In some circumstances, it may be perfectly appropriate for a charity to ask for its funding to be restricted. For example, a charity may ask a statutory funder to fund only its helpline to ensure that its lobbying activities are independent from government funding.

In general, however, NPC thinks it is preferable for charities to apply for unrestricted funding, if that is what best serves the charities' users, or would make the charities more efficient or effective. Before deciding whether to apply for a restricted or unrestricted grant, charities could ask donors that have given unrestricted funding to others in the past if they would consider doing so again.

#### Message to donors

Donors who receive applications for restricted funding should consider checking whether the charity and its beneficiaries would be better helped by unrestricted funding. This might involve asking the charity why it has not applied

for unrestricted funds, and whether it would use the donor's grant for a different purpose if it were not restricted. Provided there is no issue of mission mismatch, then the unrestricted grant may be more effective from all perspectives.

Table 2 is a guide for donors about circumstances in which it is appropriate to restrict. It highlights questions to ask and makes recommendations based on your answers.

**Table 2: Guide to when restricting is appropriate**

Your situation	Questions to ask	Recommendations
All funders	<p><b>Is there a mismatch between your mission and the grantee's mission?</b> Example: <i>a donor that normally funds refugee organisations decides to fund an environment charity because of its refugee volunteering programme.</i></p> <p><b>Is it a major mismatch?</b></p> <p><b>Is it a necessary mismatch?</b> Example: <i>funder's mission is building infrastructure of the charity sector, so it has to give to a charity that does not share its mission.</i></p>	<p><b>If the mismatch is only minor, consider unrestricted funding.</b></p> <p><b>If the mismatch is major and necessary, place restrictions,</b> but choose the least restricting level possible.</p> <p><b>If the mismatch is not necessary, consider choosing another charity to fund.</b> Example: <i>if you are funding a substance abuse charity to do mental health work, there might be a better-placed charity.</i></p>
Funders sensitive to reputational risk	<p><b>Could giving unrestricted funding distort the charity's accounts?</b> Example: <i>if you give a large amount of unrestricted funding, will it look like the charity is well funded and deter other potential funders?</i></p> <p><b>Do you have particular circumstances that make you sensitive to reputational risk?</b> Example: <i>are you a fundraising grant-maker?</i></p>	<p><b>If you are unsure, ask the charity</b> if a restriction may be helpful to it.</p> <p><b>If you are sensitive to reputational risk, place restrictions,</b> probably to the level of inputs, bearing in mind other good funding practices. Be aware that restricting may not eliminate reputation risk.</p>
Engaged funders	<p><b>Do you wish to influence the charity through this grant?</b> Example: <i>you think the charity does not have adequate financial infrastructure and so you are funding the post of a finance director.</i></p> <p><b>Do you have sufficient knowledge of the sector and the grantee organisation?</b></p> <p><b>Do you have buy-in from the grantee (trustees and management)?</b></p>	<p><b>If you do not have sufficient sector knowledge, it would be best not to influence by placing restrictions.</b></p> <p><b>If you do not have buy-in from the grantee, do not place restrictions:</b> the influence will probably not last beyond the lifespan of your funding.</p> <p><b>If you do have buy-in, place restrictions.</b> This could be to outcomes, or to an input, depending on what you are trying to achieve.</p>



**Box 11: How restricted funding can hurt charities**

One charity that has been affected by restricted funding, works with adults with mental health problems in a large city. It is the main charity helping mental health sufferers in this city, but instead of working with the tens of thousands of people who need its help, it is relatively small, only managing to work with around 400 people.

The organisation is hampered by its funding streams: 93% of its funding is restricted. Until last year, statutory funders provided around half of its funding through several different grants, but these were restricted to projects and only lasted two years. Fortunately, the statutory funders did give full cost recovery, which paid for the central office and the chief executive's post. But when these grants came to an end, so did the proportion of the central costs that they were paying for.

The other half of the funding came from grant-making trusts, which also placed restrictions, but generally did not include full cost recovery. This made the loss of any statutory funding even more damaging to the organisation, because it is the statutory funding that was covering the central costs.

Unfortunately, the local authority moved to commissioning, and set out the tender on very short notice. Due to its small amount of unrestricted income, the charity did not have the resources for someone to bid for the funding on this notice. This meant that it lost the full cost recovery funding that was paying for its chief executive.

The charity is now run by its trustees, and its only staff are the project workers who are employed by the restricted grants. The organisation is solely fire-fighting and applying for funding. It cannot look at ways to improve the service; it cannot plan new methods of helping adults with mental health problems; it can barely respond to unexpected events; and it certainly cannot put in place a strategy to help the thousands of people in its area that it currently does not reach. This is a vicious circle, since not having a proper management team or strategy makes other funders less likely to fund it.

If the charity had had unrestricted grants, then it would have been able to redeploy money into the chief executive post when the full cost recovery funding was lost. Instead, badly-designed funding has meant that there are many people with mental health problems whose needs are not being met as well as they could be.

**How do restrictions affect charities and their beneficiaries?**

NPC has seen many examples of how restricted funding has hurt charities (see Box 11). Restricted funding may be merely a frustrating constraint on a charity's control, but it may also have a detrimental impact on the charity and its beneficiaries.

The effect depends partly upon whether the charity has sufficient unrestricted funding available from other sources. For example, a charity with only 10% of its income restricted is in a better position than one with 90% of its income restricted. Although the right level of unrestricted income will depend on the charity, research indicates that if less than 25% of income is unrestricted, this will have a negative impact on the charity. Yet one in five charities is in this position.<sup>20</sup>

**Restrictions affect how flexible, innovative and timely charities can be**

In NPC's review of its work with the Execution Charitable Trust, *Trading for the future*, all of the trust's grantees said that unrestricted funding was more useful than restricted funding, and 93% said it was very much more useful.<sup>2</sup>

Grantees reported that the importance of unrestricted funding came from the flexibility it gives—80% have had to change their approach to meet changing needs amongst their clients. One grantee commented: '*[Unrestricted funding] helped us to pilot new pieces of work where we identified new needs ... We could follow an idea through without having to wait to make an application which can take six months.*'

This sentiment was reflected by a charity we spoke to in our current research: '*A lack of unrestricted funds means that [we don't] have the money to support new projects that we want to set up.*'

It is not surprising that charities say that they prefer unrestricted funding. But some foundations also agree that charities need core funding to be able to prioritise their work. In a report by the Center for Effective Philanthropy, 60% of foundations that gave core funding said they preferred it in order to be responsive to grantees' needs.<sup>17</sup>

Not all funders agree. One foundation told us that: '*I do not believe that restrictions impact charities negatively. I have heard that it would be easier for charities if the money was unrestricted, but I don't see that in my own experience. I guess all charities could do with some unrestricted funding, even though we rarely give unrestricted funding ourselves.*'

However, almost all charities that NPC talked to said that not having enough unrestricted funding meant that it took longer to respond to new needs. Unrestricted funding meant that charities could cope with unexpected events and be more innovative.

Being able to respond to unanticipated events can bring good results. In the US, analysis suggests that right-wing advocacy organisations have access to more unrestricted funding than left-wing ones. This allows them to participate in the policy process in a more pragmatic and responsive way, resulting in more conservative than liberal victories.<sup>21</sup>

**Restrictions can affect charities' infrastructure**

Many charities find that their full costs are not recovered from restricted project funding, and unrestricted money therefore helps to give the charity good administrative foundations for its work. One charity said: '*When an organisation*

has the opportunity to invest unrestricted funds into necessary “core costs”, the overall contribution is wider than simply funding an administration post. It enables the organisation to lower costs and develop ... as an organisation grows in size, so does the burden upon the infrastructure. Having an effective and well-resourced administrative system is crucial to the organisation as a whole.<sup>12</sup>

In the Baring Foundation’s report, *Strengthening the hands of those who do*, core grants had a big impact: ‘That and one other grant were our most significant support ... We were able to do all sorts of things that made our work much easier, for example, we developed an excellent database.’<sup>15</sup>

Having a decent infrastructure is important to ensure a good quality service to clients. For instance, the Lucy Faithfull Foundation has a helpline advising people worried about an adult’s behaviour towards children. It is important that the helpline gives the best service it can to its callers, so that children are safer from child sexual abuse. However, because most of the money for the helpline is restricted, the Lucy Faithfull Foundation does not have the infrastructure it would like. It does not have enough phone lines to enable people to call back to specific members of staff who have helped them before. Instead, it has to keep callers waiting, or hope they call back.

### Restrictions affect the way charities respond to emergencies or extraordinary events

Even when the costs of projects are fully funded (including direct overheads), charities still need flexible funding to allow them to respond to important issues in the sector or to respond to specific events that could dramatically influence the lives of their beneficiaries. For example, Positive Action in Housing (PAiH), a charity based in Glasgow, advises refugees and asylum seekers on housing needs. Due to a change in legislation, PAiH suddenly experienced a massive increase in demand, but restricted funding meant that it was unable to service this need. Although it had money in reserves, this money was restricted to certain projects, so PAiH could not meet the new level of demand until new funding arrived.

One funder we spoke with said, ‘Many voluntary organisations do not have the capacity to build up reserves that allow them to develop against problem scenarios.’

This belief is backed up by comments made by a charity in the literature: ‘It is difficult for us to separate everything out. It’s not just programs here and advocacy there. Sometimes issues come up that you need extra money for ... [We] need core support to respond to an emergency or crisis or issue as it comes up.’<sup>22</sup>

## Restrictions mean that grant-makers and charities are not open

The puzzle of putting together restricted budgets can mean that charities are not as open with funders as they could be. One charity chief executive told NPC: ‘[Ours] is an unusual organisation, working with a wide range of disadvantaged people with very complex needs. We get lots of pots of money from different sources for different reasons: to help people’s mental health, their confidence, give them counselling, skills, transport, etc. Bringing together a whole [organisation’s] budget when you have to chase different elements of it is very, very difficult. You have to be clever at working through systems.’

Literature suggests that ‘Grantees often spend too much time piecing together the financing puzzle of restricted grants. Core support promotes accountability by stressing the destination—social impact—more than the path a grantee takes to get there.’<sup>22</sup>

If funders are only keen on particular projects, this encourages charities to construct projects they think funders will find attractive. A respondent to a survey on unrestricted funding said: ‘It is frustrating that we have to package our core business (providing information and training) into three-year projects in order to obtain funding which is then restricted to the methods specified in the application.’<sup>12</sup>

### Restrictions can impact charities’ effectiveness

When grantees are asked about the impact of grants on their organisations, they say that larger, longer-term grants for core funding achieve the greatest impact.<sup>17</sup>

Research from the US shows that foundation chief executives believe that operating support is more effective in encouraging sustainability, administrative efficiency, and in preventing grantees’ ‘mission creep’. They also thought that operating support made a bigger impact on the organisation.<sup>11</sup>

An assessment from the Lloyds TSB Foundation for England and Wales found that unrestricted funding is better than project funding for increasing the efficiency of charities.<sup>23</sup> Table 3 shows the results of this assessment. Grantees were asked to rate core support versus restricted project support. For things such as improved efficiency, core support was much better; for improved management processes, it was slightly better. Overall, core support was better than project support for nine types of outcome, and made either no difference or was less good for only five outcomes.

Charities need flexible funding to allow them to respond to specific events that could dramatically influence the lives of their beneficiaries.

‘Many voluntary organisations do not have the capacity to build up reserves that allow them to develop against problem scenarios.’

A funder



Table 3: The impact of core support versus project support for selected outcomes<sup>23</sup>

Outcome	Core support much better	Core support somewhat better	No material difference	Project support somewhat better
Continuation of existing successful activities	•			
Increased efficiency	•			
Increased understanding of the issues faced by people with mental health problems	•			
Leveraging additional funding	•			
Education and employment		•		
Improved processes relating to management		•		
Increased confidence		•		
Increased understanding of the issues faced by relatives of people with mental health problems		•		
Local policy and practice		•		
Access to mainstream services			•	
Increased involvement in decision-making processes			•	
National policy and practice			•	
Collaborative working				•
Improved communication				•

**Restrictions are even more problematic if full cost recovery is also a problem**

The problems caused by restricted funding are further exacerbated when ‘full cost recovery’ has not been applied to project funding. When restricted grants are given to projects, but do not fully cover the costs of delivering them, funding has to be topped up by other project funders and by unrestricted funding. This problem may arise because insufficient overheads are added by the charity, or because funders are unwilling to pay for overheads. This means a constant scramble for funding that damages the services being delivered. Planning for the future becomes sidelined in order to make ends meet. Front-line work like fundraising, finance, human resources and IT suffers as a result.\*

**Restrictions coupled with conditions can cause additional problems**

Restrictions can have a more detrimental impact if they are ‘layered’ with other conditions. For example, a donor may part-fund a specific project and also request that the funds are spent within six months or a year of

receipt. This may not be realistic if other project funders do not materialise in time for the funds to be disbursed, or if other delays are encountered. A common example is when funding is given towards a new post, but the recruitment process takes a long time to complete.

If a funder not only restricts, but also, as part of its conditions, demands detailed information about how the money was spent, this might lead to ‘artificial accounting’. For instance, if a funder wants to see invoices, it may be easier to allocate the money artificially to staff costs to avoid having to photocopy numerous receipts. See NPC’s report, *Turning the tables: putting Scottish charities in control of reporting*, for more detail.

**Restrictions have fewer negative consequences when they are flexible**

Charities sometimes find that their circumstances have changed, and that they no longer need a restricted grant for the purpose for which it was granted. One volunteering charity that NPC interviewed said that it often gets grants to work in a certain geography, but might have to change the areas if it cannot find the right staff or volunteers in the original location.

\* For a detailed discussion about full cost recovery, including why it is important and how to achieve it, see NPC’s report, *Full cost recovery: a guide and toolkit on cost allocation*.

Some funders are flexible to such changes and may open a dialogue with the charity about altering the purpose of the grant (see Box 12). One foundation told NPC that charities frequently approach the foundation later for permission to use the funds for something else. This is usually successfully negotiated, particularly if the charity envisages achieving the same outcomes with the grant.

Not all funders agree. One funder told us that flexibility erodes the reason for the restriction in the first place, because the fund restricts grants to activities rather than to outcomes: *'Being flexible after a grant is given removes the basis of the original decision.'* This would be true if funders were basing their applicant decisions on activities, but if they were looking for the best outcome, they might be more flexible about changing restrictions.

## Summary

Generally, funders specifically look for charities that can achieve the outcomes they want, and often restrict funding to the work that they want to prioritise. This means that the majority of grants are restricted in some way. There is a spectrum of restrictions. Those that limit funding to beneficiaries or to outcomes are generally less onerous than restrictions to outputs. Restrictions on inputs are the most limiting.

Restrictions can be helpful to funders in ensuring that charities work towards their shared goal. However they can limit charities' flexibility, innovation, timeliness, ability to respond to emergencies, efficiency and effectiveness. To achieve maximum impact unrestricted funding should be given wherever possible.

### Box 12: BBC Children in Need

BBC Children in Need explained to NPC that it was crucial to be open to changing the terms of a grant half way through its term if this was in the interests of delivering more effective outcomes. In order to do this, the grantees have to be up-front and honest when circumstances change, and have the confidence to approach the funder and explain the situation. This means that grantees must have confidence in the funder's willingness to be flexible and in their common interest in achieving success.

BBC Children in Need builds trust between the funder and the grantee to ensure that the grantee feels comfortable approaching the foundation. This is done through a variety of ways, such as having a local point of contact for the charity at the foundation allowing a one-to-one relationship to be built up.

Difficulties in identifying and attributing impact should not be considered a barrier to providing unrestricted funding—several organisations have found ways to track the impact of unrestricted funding effectively. Reporting on unrestricted funding can help charities evaluate their impact, improve their work, decide how to allocate resources and report to stakeholders. Doing this well improves effectiveness and efficiency.

Using restrictions to manage risk is no substitute for due diligence. Grant-makers that make restrictions because of limited staff capacity might consider reviewing their internal processes and their own resources.

Charities often ask for and receive restricted funding because they expect that it is the only type of funding that funders will provide. Funders willing to give unrestricted funding must emphasise this clearly to encourage applicants.

If funders have to place restrictions, they should be flexible about changing them.



Photograph supplied by Treehouse

# Non-grant financing

**Loans, guarantees and other forms of non-grant financing are becoming increasingly established options for charities. A growing number of sources, including specialist providers and grant-makers, provide them.**

**This chapter looks at the benefits that non-grant financing brings for both charities and funders. It also considers its risks, costs and limitations, and the options that funders have.**

## Definition and background

Non-grant financing includes a range of forms of financing where there is an expectation that all or part of the funding made available to organisations will be returned. It includes 'patient capital', mission related investment, equity-like investments, loans, loan guarantees, or funding with success-linked or royalty repayments. The full range of financing options is discussed in a report from Venturesome drawing together lessons from its experience.<sup>24</sup>

This chapter focuses primarily on loans and loan guarantees, as they are the most common forms of non-grant financing. It considers how non-grant financing can be used to support charitable activity rather than to achieve a financial return.

Non-grant financing for charities is not new. NPC interviewed several funders who have given loans or guarantees to charities when they identified opportunities to further their mission in a way that made an economical use of their resources. Data from the Association of Charitable Foundations shows that a significant minority of trusts and foundations have offered loans—over 20 of its 300 or so members.<sup>25</sup>

However, over the past few years, new specialist providers of non-grant financing for the charitable sector have emerged. Some funders have begun to advertise that they offer loans. This positions them openly as providers, instead of just making loans in response to *ad hoc* opportunities that arose in the course of their grant-making. There is an increasingly accepted view that funders can further their charitable missions through their endowments (where they have them) as well as their grants. Several funders are looking at non-grant financing of charities as a more socially beneficial use of their assets.

However, several funders were concerned that, while literature exists to promote the benefits of non-grant financing, there is little that highlights

the limitations of loan financing—specifically its risks to funders and charities. Some felt that loans and other forms of investment were at times presented as substitutes for grants and a solution to 'grant dependency'. These funders feel that a reality-check is needed.

## When is non-grant financing appropriate?

Loans and other forms of non-grant financing are only suitable for certain purposes. These are listed below and are based on information provided for applicants on the websites of specialist non-grant finance providers:<sup>26-28</sup>

- bridging for future fundraising income: enabling projects to get underway earlier;
- bridging for grants: where grants are confirmed but payment has not yet been received;
- new development or income generation: including building organisational capacity to engage in new initiatives;
- property purchase or redevelopment, or other asset purchase; and
- working capital.

Some of these aspects may overlap with the applications that grant-makers receive. If an applicant is applying for a grant to launch a new service or income-generating initiative or to purchase or develop a property that could be paid for from future income, then grant-makers should consider whether a loan might be more appropriate.

However, this leaves a wide range of funding needs that cannot be met by loans or other types of non-grant financing:

- ongoing (revenue) expenditure, including service provision, research, advocacy, campaigning, organisation management and other overheads;
- capital or development funding for activities that will not generate surplus income to repay a loan; and
- capital or development funding for activities where the sources of income will not cover loan repayments (many grant-makers do not fund costs already incurred).

A number of interviewees stressed that it is important to recognise that grants are always going to be necessary. *'Grants are crucial and important. Without grant funding, many organisations would not exist or survive.'*

There is an increasingly accepted view that funders can further their charitable missions through their endowments as well as their grants.

Grants are crucial and important. Without grant funding, many organisations would not exist or survive.

A funder

Based on the recycling rate achieved by one fund that invests in charities, the total amount of all the loans is ten times higher than the original investment.

Due to the limitations of loans, some funders do not see them as a useful tool in achieving their mission, or see them as only useful in places. One funder pointed out that because of what it funds, it would never have a situation where loans would be appropriate. Another grant-maker is starting to provide loans in the areas in which it presently makes grants, and expects it will only really be relevant to its work on community development. It does not expect loans to be relevant to the majority of its grants portfolio which covers issues relating to the arts and social welfare.

One barrier to charities taking on loans is risk aversion or a lack of understanding of loan finance among charities' trustees. Existing providers note that trustees are frequently hesitant about taking on loan finance. Several funders said they would feel uncomfortable pushing charities to take on loans.

### The benefits

#### Recycling of funds means that they go further

A key attraction of loan finance is that once it has been repaid, it allows funding to be re-used to support other organisations.

The rate of this recycling depends on the repayment conditions, interest charged, and the risk of the organisations supported.

Based on the recycling rate achieved by one fund that invests in charities, the total amount of all the loans is ten times higher than the original investment, neglecting any difference in the costs of managing grants versus loans. So through being paid back and re-used, an investment of £100 adds up to a total of £1,000.<sup>24</sup>

Venturesome, a provider of social investment to charities based at the Charities Aid Foundation, found that recycling was an important factor in attracting investors to its fund.<sup>24</sup> It is seen as a way to 'get more for less' out of a set amount of funds.<sup>29</sup>

#### Building capacity of organisations

Non-grant financing offers grant-makers another tool to build the capacity of organisations. Loans are often used by charities to develop their organisational capacity and infrastructure, or to build an asset base. One provider found that the organisations it invested in had '*Increased turnover, physical assets, financial reserves and improved organisational development.*'<sup>30</sup>

A by-product of receiving loans is that it can encourage organisations to plan and monitor their finances better, in order to meet future repayments. A number of grant-makers and loans providers felt that loans encourage better financial discipline. According to one interviewee: '*Loans provide an incentive for grantees to be on top of their finances.*'

### New sources of money for the sector

Much, if not most, non-grant financing to the sector has been additional, in that it has added to, rather than replaced, grant funding streams.

Mainstream financing providers, which invest outside the charitable sector, will invest in charities where they can achieve an acceptable rate of return. When making loans, grant-making trusts often allocate funding for loans from their endowment or reserves rather than from their planned grant expenditure. NPC interviewed one funder who was spurred to set up a loan fund to complement its grant funding because of the paltry returns it was achieving on the bond markets.

### The risks and costs

#### Costs of administering

Non-grant forms of finance are more costly to administer than grants and require more assessments at the outset. Providers of non-grant financing must assess the capacity and finances of the organisation as a whole. While some engaged grant-makers may already undertake this level of analysis, many grant-makers focus primarily, if not exclusively, on the specific project they are funding, making only cursory checks on the financial health of the organisation.

The terms, including repayment periods and interest rates, must be matched to each applicant based on an analysis of cashflows—a task that requires specialist expertise. The periods of loans tend to be longer than those of grants, so require additional monitoring.

According to one funder that makes loans on an *ad hoc* basis, '*Structuring loans can be very expensive. There is definitely a learning curve and each investment is bespoke.*' However, it does expect this cost to come down as it becomes more familiar with making loans. The learning curve can be overcome by using consultants, but the process is still more expensive than making grants.

It is interesting to note that cost as a barrier was more often mentioned by funders who did not have experience of loan financing. This may suggest that cost is perceived as greater than it actually is.



## Risk to funders of not being repaid

Clearly, a key risk to the funder is the uncertainty over whether their funding will be returned or not. From one perspective, this is still less risky than making grants because at least there is the prospect of a return. However, funders often make loans from their endowments or reserves, so they need to understand what rate of recycling can be expected for their own financial planning.

To an extent, funders can choose the level of risk they are prepared to expose themselves to through their choice of: the type of organisation to support; the source of income that will fund repayment; and the terms of the loan.<sup>25</sup> For example, loans where the income is guaranteed or firmly expected are lower risk than those where the income will be made from an untested venture.

Our interviews uncovered some particular risks that occur when grant-makers opt to make loans. Some funders felt that some applicants would not treat loans from grant-makers as seriously as those from banks, and would believe that repayments were in some way optional. One funder said: *'Lots of loans get written off, so you may as well just accept this and make grants not loans.'*

Supporting this point, some funders questioned whether they would really take action against a charity that failed to repay. As discussed earlier, several funders commented that trustees find it uncomfortable when withdrawing grant funding means the closure of activities or sacking of staff. Given this, they might question whether trustees would be willing to take action against a charity by insisting on repayment or claiming assets given as security. Understandably, loan applicants may be aware of this too.

If funders are not willing, or not seen to be willing, to enforce the terms of their investments, it will reduce their recycling rate and could make any security meaningless as a way to manage risk. If applicants do apply with an expectation that they will not need to repay the loan, it becomes even more important that the funder undertakes a detailed financial assessment of whether the applicant's proposal is in fact viable.

## Risks to charities when loans are taken on inappropriately

A key concern is that charities that take on loans do not have the right level of financial planning skills to plan the loan repayments. According to one funder, *'Charities aren't ready for it yet.'* This risk can be reduced by accompanying loan funding with capacity building support. This is similar to the support Futurebuilders England, a government-backed loan fund, provides to investees. It takes time

for charities to build the necessary skills. One funder felt that there was a *'Tendency amongst loan providers to assume that charities can take on a loan overnight.'*

There are implications for the charity if funding for repayments is not secured. Loans amplify the risks associated with uncertain funding streams. One grant-maker was particularly concerned about the impact on its grantees of taking on loans to build capacity to get public funding, which they either do not get or which is cut off after three years. Another loan-making funder explicitly avoids making loans to charities to bid for public funding for this reason.

Futurebuilders England, which gives loans to organisations to enable them to take on contracts, found that most organisations were unable to meet the full cost of their services, including loan repayments, from their contract income.<sup>31</sup> This means that the remainder is being paid for from reserves or other sources of income.

The Young Foundation noted that loans could have distorting and distracting effects on charities. For example, some have to rent out their building space for commercial use at the expense of core activities in order to meet loan repayments.<sup>32</sup>

When grants are used to support specific initiatives or activities, their failure has limited financial consequences for the rest of the organisation. When loans are used, the organisation remains liable for payments, which must be met from other sources of income.

## Options for grant-makers

A number of grant-makers already make loans. Some offer loans on an *ad hoc* basis as they identify opportunities through their grant-making. Others openly advertise their loans and solicit applications.

The majority of grant-makers who make loans use partners or consultants to undertake the financial assessment, to structure the deal, and to manage the relationship. This can be undertaken either through partner finance providers or freelance consultants.

## Is it okay not to make loans?

Yes, it is okay not to make loans. Several grant-makers NPC spoke with, although open to the idea of loans, could not see how they could be used as a tool to further their objectives in their areas of work. This was particularly the case where grant-makers funded research, advocacy or policy work.

Another grant-maker felt that the benefits of offering non-grant financing were too marginal to make it worth investing in developing the skills and processes needed to make loans.

Clearly, a key risk to the funder is the uncertainty over whether their funding will be returned or not. In a way, this is less risky than making grants because at least there is the prospect of a return.



**Box 13: The Northern Rock Foundation**

The Northern Rock Foundation makes loans available to charities, and delivers them in partnership with Charity Bank. Northern Rock Foundation discusses loans with applicants and identifies applicants within its area of interest. Charity Bank conducts financial assessment of the organisation and recommends the terms for the funding, which are then subject to approval by the Northern Rock Foundation. Charity Bank manages the ongoing relationship with grantees and collects repayments on behalf of Northern Rock.

Even if grant-makers choose not to make loans themselves, it is important they consider whether the funding requests they receive could be funded by a loan, to ensure they are making the best use of their charitable grants.

However, even if grant-makers choose not to make loans themselves, it is important they consider whether the funding requests they receive could be funded by a loan, to ensure they are making the best use of their charitable grants. If the request can be loan-funded without introducing too much risk, then this is preferable, because it frees up grant-funding to support work that can only be funded through grants.

Specialist non-grant financing providers and intermediaries can advise on whether a proposal from an applicant would be suitable for loan funding.

**How should grant-makers offer loans?**

If funders do choose to make loans, then it is important to ensure that they have the capacity to: assess organisations' finances; match loan terms to applicants' needs; and manage the relationship on an ongoing basis.

Most grant-makers we spoke to who make loans use consultants to provide these skills, or make loans in partnership with specialist non-grant financing organisations or other intermediaries. Intermediaries can reduce the costs, and bring risk assessment skills which will reduce both the risk to the grant-maker of not being repaid, and the risk to the charity of failure.

According to one grant-maker that gives loans, *'Loans can be a useful tool to have in your tool box but you've got to be qualified to do these things.'* Grant-makers can develop these skills themselves if they make lots of loans. *'If you don't make lots of loans yourself, then it is better to partner with someone who does.'* A case study of how this works appears in Box 13.

It is important for grant-makers to think about how they will monitor repayments and respond to defaults before making loans. It should be made clear to applicants at the outset whether or not the grant-maker is prepared to convert loans into grants and under what circumstances.<sup>25</sup>

**Summary**

Many types of activities that charities undertake will never be suitable for loan funding or other types of non-grant financing. However, opportunities do arise for grant-makers to further their missions through making loans to charities. During our research, NPC encountered several grant-makers that give loans on an *ad hoc* basis to take advantage of these opportunities. This enables them to achieve more with their funds and also to reserve their grants for funding activities that can only be grant-funded.

However, making loans responsibly requires specialist skills, which can be difficult and uneconomical to develop for grant-makers who give loans infrequently. Without proper assessments, or a clear understanding of what will happen if the loan cannot be repaid, making loans creates risks for both grant-makers and applicants.

Most grant-makers who make loans now use specialist intermediaries or consultants who undertake financial assessments, and manage relationships with the funded organisations, reducing risks and costs.

# Conclusions

**NPC has long argued that the market for charitable funding is broken and needs to work better. Our aim is to help charities and funders be as effective as possible to maximise the impact on their beneficiaries.**

This report has looked at the impact of funding and how grant-makers can make it more effective. Charities also have a role in making the funding market more effective, and this report raised a number of questions about how they approach relationships with funders. Although the issues the report has discussed (size and length of funding, restrictions and non-grant financing) are separate, there are factors that impact on all of them: dependency, risk and capacity.

## Dependency

Some grant-makers try to avoid the problem of dependency by giving smaller grants, shorter term grants or restricting their funding. But this can reduce the impact of the grants.

In reality, most charities will always be dependent on grants. By definition, they do not have, and are unlikely to generate, their own entire income. Unless the need for charities disappears, then dependency will continue to be a natural feature of funding relationships.

In taking steps to ensure charities do not become dependent on them, grant-makers often shift dependency to other funders. A better approach is to respond pro-actively to the risk that charities will not secure other funding. This report has highlighted how to do this.

## Risk

NPC believes that risks are inevitable in funding. Instead of attempting to avoid them, grant-makers should assess and manage them. Some steps to avoid risk can reduce the impact of funding by giving less than appropriate amounts, or by placing restrictions on funding where they are not necessary.

## Capacity

Grant-makers told us that the effort they could afford to put into assessing applicants affects their preparedness to give both bigger and longer grants, and unrestricted funding. So the capacity of funders is clearly linked to their ability to create impact through funding.

It costs more to be an effective grant-maker. In seeking to improve the effectiveness of their funding, grant-makers may need to invest more in their own staff and processes. NPC plans to undertake future research into a cost-benefit analysis of investing in grant-making capacity.

## Conclusions

Giving money is easy, but to do it effectively requires investment in the capacity of funders, an ability to accept risk, and a willingness to do things differently. By reflecting on the issues raised in this report, grant-makers could improve their funding so that it makes the greatest impact. They can change the funding market, improve charity behaviour, and, most importantly, deliver better outcomes for beneficiaries.



Photograph supplied by Edinburgh Cyrenians

# Appendices

## Appendix 1: Interview questions for grant-makers

As research for this project, NPC conducted semi-structured interviews with grant-makers. Below are the questions we asked.

1. **What considerations are taken into account when making decisions about size and length of grants? For example,**
  - characteristics of the charity, its work and what is funded;
  - impact on the charity's effectiveness;
  - confidence in/knowledge of/trust in the charity;
  - resources of the foundation;
  - capacity of the foundation;
  - attributing impact (different from making impact);
  - fairness; and
  - tradition.
2. **For the considerations you mentioned, how do you take each into account?**
3. **How did you balance these in making decisions about grants?**
4. **How do you set the criteria for different types of grants? For example,**
  - set for the foundation as a whole;
  - set for particular grant programmes; and
  - set on a grant-by-grant basis.
5. **Who inputs into decisions on the types of grants made? For example,**
  - trustees;
  - chief executive; and
  - other staff.
6. **Is that the same for size, length and restrictions on grants?**
7. **Have you always done it this way and do you think you will continue to do so?**
8. **Do you place restrictions on grants? What percentage is restricted?**
9. **What sort of restrictions do you place on grants? Are these suggested by the foundation, or by the grantee?**
10. **What considerations are taken into account when making decisions about restrictions on grants?**
11. **What do you see as the biggest barrier to giving unrestricted funding?**
12. **How do you think grant-makers should respond to non-grant financing?**
13. **Has your foundation ever considered providing non-grant financing? If so, what were the pros/cons?**
14. **Do you think grant-makers should be concerned or check whether an application could potentially be funded by a loan or investment instead?**
15. **What do you see as the biggest barriers to giving out loans?**

## Appendix 2: Interview questions for charities

NPC conducted semi-structured interviews with charities on their views about the types of funding they received. Below are the questions we asked, along with some of the prompts that we had.

1. **How would you characterise the size and length of your grant funding? Current situation? Are any trends evident or emerging?**
2. **Have the size and length of grants been a problem for the organisation? In what ways? For example,**
  - merely annoying;
  - inability to fund general overheads;
  - inability to adapt to changes to sector or be flexible;
  - mission creep;
  - additional workload to provide categorical evidence of spending to grant-makers;
  - ability to deliver services;
  - ability to set strategic direction;
  - ability to measure results;
  - ability to attract or retain staff;
  - impact on beneficiaries;
  - having to wait for more funding before work can commence (eg part-funded);
  - mismatch of funding to need; and
  - less effective.
3. **Have you been able to address this and how?**
  - Have you been able to change a funder's size and length of grants in the past? Why and how?
  - Or do you have any plans to do so?
4. **What factors do you think come into play when funders have decided how much to fund/ for how long to fund?**
5. **What proportion of your grant income is restricted funding at present? Do you notice any evident or emerging trends?**
6. **What are the most common types of restrictions? For example,**
  - beneficiaries;
  - outcomes; and
  - activities.
7. **Have the restrictions on funds been a problem for the organisation? In what ways? For example,**
  - merely annoying;
  - inability to fund general overheads;
  - inability to adapt to changes to sector or be flexible;
  - mission creep;
  - additional workload to provide categorical evidence of spending to grant-makers;
  - ability to deliver services;
  - ability to set strategic direction;
  - ability to measure results;
  - ability to attract or retain staff;
  - impact on beneficiaries;
  - having to wait for more funding before work can commence (eg part-funded);
  - mismatch of funding to need; or
  - less effective.



8. Have you ever asked a donor to change their restrictions because your (or the sectors') circumstances have changed?
  - Have you been able to change a funder's restrictions in the past? Why and how?
  - Or do you have any plans to do so?
9. What factors do you think come into play when funders have decided whether to give you restricted funds?
10. Is there any case for restricted funding in your organisation? Please explain.
11. Have you ever turned down funding because of its restrictions?
12. Do you adapt your funding applications to deliver a donor's mission?
13. Do you apply for size and length according to what you think the donor will fund?
14. Do you ask funders for restricted funding for your own reasons?
15. Do you find it easier to monitor grants and report to donors (and evaluate and attribute results) if they are restricted? Why/why not?
16. Have you ever received non-grant financing (eg loans)?
  - If so, what was it for? Did you apply or was it suggested that you should be given a loan not a grant by the donor?
  - If not, is there any place for this kind of funding in your organisation?

### Appendix 3: Example report for monitoring whole organisation outcomes

One of the reasons why funders favour restricted funding is because it is easier to monitor. However, when giving unrestricted funding, funders can monitor the outcomes of the whole organisation. Below is an example report for monitoring whole organisation outcomes, used by First Step Trust as part of our research into standardising reports, published in *Turning the tables in England: Putting English charities in control of reporting*.

#### Core report – whole organisation

Organisational information		
Organisation Name	First Step Trust (FST)	
Address	32-34 Hare Street Woolwich London SE18 6LZ	
Telephone Number	020 8855 7386	
Contact Person	Carole Furnivall	Job title: Joint Chief Executive
		Date 13/03/2008
What are you trying to achieve?		
<b>Overall aims</b>		
To enable people who would not otherwise be able to access employment because of mental health problems, disabilities and other disadvantages to gain the benefits of work by operating as a voluntary workforce running small, not for profit, businesses.		
To involve people at all levels of the organisation, sharing responsibility as colleagues, in order to help individuals gain more control over their own lives, assistance to understand the pattern of breakdown or behaviour that contributes to their social exclusion or disadvantage and the means to deal with these.		
To enable people to develop the confidence, skills and work history to move on to employment and to assist them to do so.		
To provide the structure and opportunities through work that enable those with more severe and enduring problems to keep themselves well and maintain a good quality of life.		

How are you doing this?	
<b>Summary of main activities this year</b>	
<p>FST aims to enable people to access the benefits of work by engaging them as voluntary workforce, operating small not for profit businesses. We currently have 13 such businesses across the country, trading in a range of areas: garden maintenance, painting and decorating, garage services, restaurant and catering services, print design and production, office administration and finances. Four of these operate in secure psychiatric settings.</p> <p>Within each project, the workforce are fully involved in all aspects of the work, supervising specific work areas, dealing with customers, driving the works vans, handling petty cash, holding keys to the safe and the premises and training other members of the workforce.</p> <p>We also assist people to move on to employment, offering individually focused support through a personal development plan, running regular job clubs at each project and arranging work placements with other employers to expand their experience.</p> <p>The main focus of development this year has been the consolidation of a large vehicle recycling project in Salford. Running as an MOT Centre and providing garage services, in addition to recycling end of life vehicles, this project represents a newer, more commercially productive model than FST's earlier projects. The project has piloted a number of new initiatives for FST, including targeting the wider population of those who are unemployed, especially under 25s; providing work activities to support the discharge of people from the local medium secure unit; partnership with the local PCT in running an occupational health service within the workplace offering assistance with stopping smoking, drug awareness and healthy living; and closer partnership with the local business community.</p> <p>We have also reorganised our work project in Broadmoor Hospital, FST Berkshire, to offer more demanding work activities and higher level of skill development with facilities maintenance contracts and print design and production.</p>	
<b>Outputs for the year– How many services have you run?</b>	
1	1,000 people who were long-term unemployed attended FST's projects delivering over 240,000 hours of work in the community.
2	340 people from Black and Asian minority ethnic communities engaged with the projects nationally, exceeding the percentage in the local population at every project.
3	310 people attended FST job clubs within the projects gaining support in writing CVs, job search, and interview skills.
4	60 local businesses provided work experience placements for people preparing to move on from FST.
5	£630,000 was earned as trading income for reinvesting in the projects.
<b>What difference have you made?</b>	
<b>Major outcomes</b>	
1	<b>Dramatically increasing core skills:</b> 80% of those attending improved their employment potential, showing increases in work skills as measured by Personal Development Plan reviews.
2	<b>Tackling unemployment amongst the most disadvantaged:</b> 90 people succeeded in moving on to paid employment.
3	<b>Raising vocational qualification level:</b> 150 people gained nationally recognised certificates in ICT, Health & Safety, Food Hygiene, Automotive Skills, Office administration, First Aid and Literacy at levels ranging from basic Skills for Life to NVQ 2.
4	<b>Engaging people with most serious mental health needs:</b> 53% were people with severe and enduring mental health problems —ie, in receipt of the enhanced level of the Care programme approach
5	<b>Crime diversion:</b> Eight people discharged from forensic services successfully stayed away from re-offending.

### Case studies, quotes and descriptions to illustrate outcomes

a) Jack started at the project in November 2006, while still a prisoner at Thorn Cross Young Offenders Institution. He was accepted onto the FST SMaRT Driving Ambition scheme in January 2007 and quickly passed his driving license theory test. He successfully passed his driving test in June and left the SMaRT project in July. He is now working for DHL driving a van and is due to be released from prison towards the end of the year.

*"If there's something I want I'll go out and get it, but I never liked the classroom environment. That's why I've enjoyed working at First Step Trust and have done well here—I wasn't given loads of paperwork to do. I've wanted to learn to drive ever since I could sit in a car, so it's a dream come true for me, and having my license will really help me get a job when I leave prison."*

*"I like being here because I've gained loads of experience, been trusted with work and enjoy what I do—welding. I have learnt how to speak to people who are different to me, like customers, visitors and staff. Back in the West Midlands I used to go out and drink and that's how I would get my confidence, but here I've developed confidence because of the project and the work I do. I'm sure if it wasn't for getting this experience here I'd have ended up back inside—I've now realised there's nothing out there for me the way I used to live."*

b) Mary who has since achieved a modern apprenticeship with Mitsubishi.

*"For nine months I didn't leave the house. Now I want to get out of bed in the mornings. I have never enjoyed doing anything so much in my life—SMaRT has exceeded my expectations in terms of what I thought it would be possible to do. My future definitely lies in mechanics and here I am studying qualifications that will help me to get a job. The guys I work with are awesome! They treat me exactly the same as everyone else and they go out of their way to help me. I thought they might be 'anti-female' but this hasn't been the case; we all get on really well together. It's a really co-operative team—we all pull together as a team to get the job done."*

c) Annie, gaining experience in FST's main finance office.

*"I feel I have come a long way since joining the project, gaining in confidence. I have moved out of the hostel into my own flat. I have a better understanding of how accounts are kept and have improved my communication skills. I am also more hopeful of being able to gain paid employment now that my skills and qualifications are more up to date. It helps a lot that FST will give me a work reference based on my experience in the finance office."*

### Other developments for the organisation (e.g. new partnerships, staff, strategies, evaluations)

#### 1. Piloting more commercial trading ideas

In order to ensure that the projects provide the expectations of real work, we have been piloting a more commercially competitive project in Salford, providing MOT and garage services. This has proved highly successful, achieving a strong work culture, resulting in improved rate of move on to employment and modern apprenticeships. The greater capacity for generating income is also a vital contribution to its longer term security.

#### 2. Increased access to qualifications

We have also stepped up our capacity to offer vocational qualifications either within the projects or linking with local training facilities. Qualifications have been offered in automotive skills, office Administration, Health and Safety, First Aid, Basic Food Hygiene, IT and basic skills in literacy.

#### 3. Improved monitoring systems

We have begun development of a new web-based database to improve management access to project monitoring data.

#### 4. Developing Health promotion within the workplace

In Salford we have piloted, in partnership with local PCT, sessions for the workforce in stopping smoking, drug awareness and healthy eating. We have also nominated a trustee who is a GP to develop a health promotion strategy across all our projects.

#### 5. Evaluation of FST benefits to local statutory agency funders

For some years we have observed the way people's usage of mental health services reduces as they become involved with FST. This year, we have developed a health economics survey to gather data over the coming year to measure this impact more systematically.

Why are your activities important?
<p>There is growing concern nationally about the large numbers of people with mental health problems who are long-term unemployed (75% to 80% as compared with 50% for other disabilities). It is now clearly recognised that work is good for your mental health and assists both recovery and maintenance of good mental health. However, recent government initiatives to enable people who have been off sick for years to return to work (Pathways to Work) has been far less effective in assisting people with mental health problems than people with other disabilities.</p> <p>We believe the impact of years of illness and absence from the job market cannot be overestimated. People recognise they have become virtually unemployable as a result, lose all self belief and abandon any aspirations to employment. The growing number of schemes designed to place people directly in employment are not geared to deal with this. FST is one of very few organisations providing work opportunities to people who do not have the necessary confidence, skills or experience to even try for employment. We are also the only organisation offering such a service within secure psychiatric settings.</p> <p>FST's activities are important because they:</p> <ol style="list-style-type: none"> <li>a) Provide the opportunity to work to people who are not able to use the more usual employment support services;</li> <li>b) Thereby enable people to develop the confidence, skills and experience to go on to employment; and</li> <li>c) Continue to provide a place of work, all be it voluntary, for those who are not able to progress on to employment where they can still gain many of the social and personal benefits of working.</li> </ol>
What have you learned and what will you do in the future?
<p><b>What didn't work and why?</b></p> <p><b>Integration of Jobcentre Plus and LSC contracts into the project:</b> Having been successful in obtaining two small contracts for Jobcentre Plus and Learning and Skills Council to support people to access college and employment, we have decided not to do so again. The financial benefit of the contracts is far outweighed by the amount of administration required to run them, out of all proportion to the scale of the activity. It may well work better for large contracts but we concluded such activities are better left to large-scale specialist providers and we will supply our formal training needs through liaison with existing providers in future.</p> <p><b>Moving people on into employment:</b> Once we exclude from the total of workforce those who are not eligible for employment because they are currently detained in secure services, the percentage of workforce members moving on into employment is around 15%. While we view this as a success in many ways because of the numbers of our workforce who have serious and enduring mental health difficulties, our original plans in introducing the Employment Development Workers and Personal Development Plans had anticipated a more focused progression through to employment. Some of the projects have been more impressive in achieving this than others and there is a need to ensure all projects are equally successful. The main barrier to achieving this is the difficulty in consistently maintaining a strong work culture where the expectations of individuals are driven by the need to meet the customers' requirements, rather than focusing on limitations arising from the workforce's difficulties.</p>

### Lessons learned and future plans

FST has 2 major objectives in the coming two to three years to address the wider issues raised by the points above:

- a) Development of existing projects towards more commercially competitive trading activities, particularly garage services (as piloted at FST SMaRT) where the customers' demands are more immediate and stringent than in gardening.

This enables us to offer a wider range of more marketable job skills, as well as generating a workplace culture that challenges people to respond to the greater pressures of the work and assists them to become more employable.

Along with this we will introduce a time limit of one year on people's stay, together with a commitment to work with us to move on into employment within the year.

However, we remain committed to those whose disability is such that FST is their means of keeping themselves well in the community, and for whom paid employment is well into the future, if at all. So there will be a proviso that anyone needing to carry on attending after a year can do so if the objectives are agreed with their care coordinators.

Alongside this will be more intensive support to assist people to move into employment.

- b) Increased income generation through shifting trading activities in this way and reducing financial dependence on certain forms of statutory funding.

## Appendix 4: Resources on grant-making

There are many resources available to grant-makers.

NPC's reports that might be useful in deciding how to structure funding include:

- Funding success: NPC's approach to analysing charities
- Surer funding: Improving government funding of the voluntary sector
- Full cost recovery: A guide and toolkit on cost allocation
- Trading for the future: A five year review of the work of the Execution Charitable Trust and New Philanthropy Capital
- Turning the tables: Putting Scottish charities in control of reporting
- Turning the tables in England: Putting English charities in control of reporting

*The Grant-making Tango: Issues for funders* by Julia Unwin provides an overview of many of the issues encountered by grant-makers in their relationships with grantees. It is available from the Baring Foundation's website: <http://www.baringfoundation.org.uk/GrantmakingTango.pdf>.

A number of organisations produce guidance for grant-makers on different aspects of grant-making:

- Association of Charitable Foundations ([www.acf.org.uk](http://www.acf.org.uk))
- GrantCraft ([www.grantcraft.org](http://www.grantcraft.org))
- Grant-makers for Effective Organisations ([www.geofunders.org](http://www.geofunders.org))

There are some resources available about loans. Venturesome's report, *The Venturesome model: reflecting on our approach and learning 2001-2006* by M. Bolton, J. Kingston and J. Ludlow, discusses the range of financing options.





Photograph supplied by Christopher Thomond and The Guardian

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# Other publications

## Community

- **Short changed:** *Financial exclusion (2008)*
- **Lost property:** *Tackling homelessness in the UK (2008)*
- **Hard knock life:** *Violence against women (2008)*
- **When I'm 65:** *Ageing in 21<sup>st</sup> Century Britain (2008)*
- **Not seen and not heard:** *Child abuse, a guide for donors and funders (2007)*
- **A long way to go:** *Young refugees and asylum seekers in the UK (2007)*
- **Home truths:** *Adult refugees and asylum seekers (2006)*
- **Inside and out:** *People in prison and life after release (2005)*
- **Grey matters:** *Growing older in deprived areas (2004)*
- **Side by side:** *Young people in divided communities (2004)*
- **Local action changing lives:** *Community organisations tackling poverty and social exclusion (2004)*
- **Charity begins at home:** *Domestic violence (2003)*

## Education

- **After the bell:** *Out of school hours activities for children and young people (2007)*
- **Misspent youth:** *The costs of truancy and exclusion (2007)*
- **Lean on me:** *Mentoring for young people at risk (2007)*
- **Read on:** *Literacy skills of young people (2007)*
- **On your marks:** *Young people in education (2006)*
- **What next?:** *Careers education and guidance for young people (2005)*
- **School's out?:** *Truancy and exclusion (2005)*
- **Making sense of SEN:** *Special educational needs (2004)*

## Health and disability

- **Heads Up:** *Mental health of children and young people (2008)*
- **A life less ordinary:** *People with autism (2007)*
- **What price an ordinary life?** *The financial costs and benefits of supporting disabled children and their families (2007)*
- **Don't mind me:** *Adults with mental health problems (2006)*
- **Valuing short lives:** *Children with terminal conditions (2005)*
- **Ordinary lives:** *Disabled children and their families (2005)*
- **Out of the shadows:** *HIV/AIDS in Burundi, Democratic Republic of Congo and Rwanda (2005)*
- **The hidden assassin:** *Cancer in the UK (2004)*

- **Caring about dying:** *Palliative care and support for the terminally ill (2004)*
- **Rhetoric to action:** *HIV/AIDS in South Africa (2003)*

## Cross-cutting research

- **Striking a chord:** *Using music to change lives (2006)*

## Improving the voluntary sector

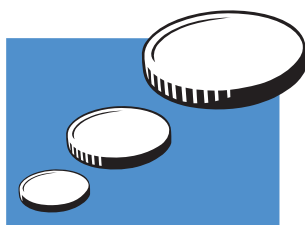
- **Critical masses:** *Social campaigning, a guide for donors and funders (2008)*
- **Valuing potential:** *An SROI analysis on Columba 1400 (2008)*
- **Turning the tables in England:** *Putting English charities in control of reporting (2008)*
- **Turning the tables:** *Putting Scottish charities in control of reporting (2008)*
- **On the bright side:** *Developing a questionnaire for charities to measure children's well-being (2008)*
- **Funding success:** *NPC's approach to analysing charities (2005)*
- **Surer funding:** *Improving government funding of the voluntary sector (2004, published by acevo)*
- **Full cost recovery:** *A guide and toolkit on cost allocation (2004, published by NPC and acevo)*
- **Just the ticket:** *Understanding charity fundraising events (2003)*
- **Funding our future II:** *A manual to understand and allocate costs (2002, published by acevo)*

## Environment

- **Green philanthropy:** *Funding charity solutions to environment problems (2007)*

## International

- **Philanthropists without borders:** *Supporting charities in developing countries (2008)*
- **Going global:** *A review of international development funding by UK Trusts and Foundations (2007)*



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Using this research it advises clients and their trusted advisors, and helps them think through issues such as:

- Where is my support most needed, and what results could it achieve?
- Which organisation could make the best use of my money?
- What is the best way to support these organisations?

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